Comments of

The National Association of Mortgage Brokers

on

Board of Governors of the Federal Reserve System
Proposed Rule amending Regulation Z
74 Fed. Reg. 43232, August 26, 2009

DOCKET NO. R-1366

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VI. Policy Recommendations / Alternatives to the Proposed Rule

- **A.** Withdraw the proposed prohibition on payments to loan originators.
- **B.** Delay implementation of any final rule until after Congress has acted upon currently proposed legislation that would create a new Consumer Financial Protection Agency.
- **C.** Permit either the creditor, or a mortgage broker or other third-party originator to provide the required pre-application disclosures.
- **D.** Eliminate disclosure of the APR and instead require disclosure of payment terms, settlement costs and monthly payment.
- **E.** Establish a reasonable tolerance threshold, within which certain terms could change after the final TILA disclosure but prior closing without requiring re-disclosure and without triggering an additional waiting period.
- **F.** Define "loan originators" in the same way that they are defined under the SAFE Act.
- **G.** Ensure that loan originators retain their ability to receive compensation as a percentage of the loan amount and not just a flat fee.
- **H.** Explore the benefits of an "Alternative 3" to the proposal prohibiting payments to loan originators based upon the terms or conditions of a loan, and publish for comment a new proposed rule that includes such an alternative.
- **I.** Adopt an anti-steering rule that mirrors the anti-steering rule in H.R. 4173.
- **J.** Address all "up selling" in connection with mortgages and other financial transactions, not just YSP.

VII. Administrative Procedures Act Compliance

- **A.** The Proposed Rule fails to articulate an adequate rationale and supporting basis for key provisions.
- **B.** The Proposed Rule failed to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them.
- **C.** The Proposed Rule solicits significant new data or other information relevant to its provisions, impermissibly denying the public the opportunity to comment.
- **D.** The Board must re-propose its revisions to Regulation Z to permit public comment on rationales and supporting data not presented not in the Proposed Rule.
- **E.** The Board must address key questions before moving forward in the rulemaking process.

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The National Association of Mortgage Brokers ("NAMB"), together with its members and affiliates located in all fifty States and the District of Columbia, are committed to serving America's homeowners and those who aspire to become homeowners. As part of this commitment, NAMB advocates for public policies that serve mortgage consumers by promoting competition, facilitating homeownership, and ensuring quality service. To that end, NAMB respectfully submits these comments on the Board of Governors of the Federal Reserve System's Proposed Rule to amend Regulation Z (74 Fed. Reg. 43232, Aug. 26, 2009) ("Proposed Rule").

I. Executive Summary

The Federal Reserve Board ("Board") began its current review of Regulation Z in December 2004. Since that time, our mortgage, housing, and financial markets have endured tremendous turmoil and significant changes. We have seen a fundamental shift in our understanding and acceptance of what truly lay at the root of the current crisis; and it has become clear that the policies, practices, and behaviors which contributed to this crisis were not limited to any one origination channel, or to the collective market for origination services. Instead, it was a confluence of the policies and practices in all phases of the mortgage market that precipitated the issues the Board is attempting to address in the Proposed Rule.

Additionally, legislative and regulatory changes at both the state and federal levels have significantly changed the landscape of our mortgage and housing markets. In 2008 alone, Congress enacted the S.A.F.E. Mortgage Licensing Act ("SAFE Act"); the Board finalized rules under the Home Ownership and Equity Protection Act ("HOEPA") for high-cost mortgage loans ("2008 HOEPA Final Rule"); and the U.S. Department of Housing and Urban Development ("HUD") proposed and finalized long-awaited revisions to Regulation X under the Real Estate Settlement Procedures Act ("RESPA") ("2008 RESPA Final Rule"). Earlier this year, the Board finalized rules implementing the Mortgage Disclosure Improvement Act ("MDIA"), which supplemented the requirements of the 2008 HOEPA Final Rule; and the U.S. House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 ("H.R. 4173"). However, despite these legislative, regulatory and market changes, the Proposed Rule rests predominantly upon anecdotal evidence and the testimony of interested parties at Board hearings, which were conducted at a time when the mortgage market was vastly different than the one which exists today.

NAMB's detailed comments below present an analysis of the Proposed Rule in light of current market realities, relevant studies, available data, and applicable law. NAMB evaluates the Proposed Rule's goals, rationales, and use of evidence and data to support the conclusions of fact and law arrived at by the Board. NAMB also explores which elements of the Proposed Rule would effect meaningful and beneficial change, and which would present serious issues for consumers and our mortgage market. Finally, where appropriate, NAMB offers alternatives to the Board's Proposed Rule that NAMB believes would better serve consumers and the market.

In a review of any policy initiative such as this, it is critical that, above all else, two criteria are met.

First, the governmental entity pursuing such an initiative must identify and articulate proper policy goals. These goals should be identified through a careful analysis of how consumers are currently served by mortgage markets, and by positing what systemic traits those markets should have to ensure that consumers' interests are best protected.

Second, the governmental entity must consider a full range of alternative means to achieve the articulated policy goals, and subject each of those possible alternatives to rigorous scrutiny to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, the entity should carefully consider data and quantifiable evidence, produced by other governmental entities with particular expertise in the subject area and independent academic researchers whose backgrounds permit them to make an informed and disinterested assessment of relevant facts.

NAMB believes that the Proposed Rule meets these criteria in some respects, but fails to do so in others.

NAMB applauds the Board for its continued efforts to address the problems that exist in our mortgage market, and NAMB shares the Board's resolute commitment to consumer protection. However, NAMB strongly objects to certain elements of the Proposed Rule that will ultimately serve neither the consumer nor the mortgage market, because these elements would impede competition, fail to reflect the most current and authoritative research, and/or do not consider the most effective and least burdensome alternatives.

As this comment letter discusses in greater detail below, the Proposed Rule is flawed on numerous grounds, including but not limited to the following:

- The Proposed Rule fails to adequately address significant changes in the market, which have occurred since the Board began its review of Regulation Z.

- The Proposed Rule seeks to add a layer of new compliance requirements to an industry that is already strained by the necessity of implementing previously enacted final rules issued by the Board and HUD.

- The Proposed Rule changes the definition of loan originator, which was established by Congress in the SAFE Act, without any analysis, evidence or studies to support the new definition.

- The Proposed Rule would greatly impede competition in the market for origination services, and thus disadvantage consumers, by imposing dramatically different regulatory burdens on competing entities without any rational basis for drawing such a distinction.

- The Proposed Rule fails to satisfy the established test for determining whether an act or practice is unfair under the FTC Act.

- The Proposed Rule fails to consider any standards employed by states in interpreting their unfair and deceptive trade practices statutes.

- The Proposed Rule relies exclusively upon anecdotal evidence and the hearing testimony of interested parties to support its conclusions, while ignoring relevant independent research that contradicts many of the claims relied upon in the proposal.

- The Proposed Rule fails to articulate proper policy goals.

- The Proposed rule fails to consider less burdensome and more effective alternatives to achieve the desired policy goals.

- The Proposed Rule does not give adequate consideration to how its proposals relate to, or potentially conflict with, other provisions of federal and state law.

The Proposed Rule's shortcomings are most evident in its provisions restricting loan originator compensation.

For example, the Board has not offered any analysis, evidence or studies demonstrating how it arrived at the conclusion that mortgage broker companies should be treated in the same manner under the Proposed Rule as individual loan originators working for said companies. Further, the Board's expansion of the definition of "loan originator" to include mortgage broker businesses, and those businesses engaged in "table funded" transactions, constitutes deliberate disparate treatment of small businesses that cannot, or choose not to, provide funds for mortgage transactions out of their own resources. By defining the term loan originator in this manner and seeking to prohibit certain payments to loan originators, the Board is regulating the compensation and profit structures for some business entities and not for others, which are in direct competition with those entities.

Even if it is not the Board's intent to treat similarly situated competitors differently, regulating the manner of compensation for some, but not all competing entities within the marketplace will have a disparate impact on those entities affected by the regulation.

Small businesses offering mortgage loan origination services will be negatively and disproportionately impacted by the Proposed Rule. Including lender and mortgage broker businesses in the definition of "loan originator" limits the flexibility and loan pricing and product options that these business entities can offer consumers in the marketplace. With no similar restrictions placed on typically larger direct competitors that choose to at least temporarily provide funds for mortgage transactions out of their own resources, competition will be limited and the smaller entities that have had their compensation regulated by the Proposed Rule will eventually be forced out of business.

Further, the Board's choice to regulate compensation mechanisms exclusively at the loan originator level ignores the depth and complexity of the secondary mortgage market. The type of incentive compensation that the Board seeks to prohibit was originally created by securitizers who were packaging loans and assigning value to their individual components. The Board has not offered any evidence or analysis of market data indicating why lender companies that receive incentive payments and compensation from secondary market sources are treated differently than mortgage broker companies under the Proposed Rule.

II. Background Information on Mortgage Brokers & Loan Originators

A. The National Association of Mortgage Brokers

The National Association of Mortgage Brokers is the voice of the mortgage broker industry, representing the interests of mortgage professionals and homebuyers nationwide. Established in 1973 and headquartered in McLean, Virginia, NAMB is the oldest and largest national trade association representing the mortgage broker industry.

Today, NAMB advocates on behalf of more than 70,000 small business mortgage professionals located in all 50 states and the District of Columbia. NAMB also represents the interests of homebuyers, and advocates for public policies that serve mortgage consumers by promoting competition, facilitating homeownership, and ensuring quality service.

NAMB is committed to enhancing consumer protection and promoting the highest degree of professionalism and ethical standards for its members. NAMB requires its members to adhere to a professional code of ethics and best lending practices that fosters integrity, professionalism, and confidentiality when working with consumers. NAMB also provides its members with access to professional education opportunities and offers rigorous certification programs to recognize members with the highest levels of industry knowledge and education.

Additionally, NAMB serves the public directly by sponsoring consumer education programs for current and aspiring homebuyers seeking mortgage loans.

B. The Role of Mortgage Brokers & Loan Originators

Mortgage brokers bring greater competition to the market for origination services and often provide consumers with a local alternative to using a large national bank or lender. Mortgage brokers have been a key catalyst in expanding product choice, reducing marginal prices, and serving new customers, particularly in traditionally underserved markets.

Today, the term mortgage broker is often used interchangeably to describe both a business entity, competing in the market for origination services with banks, credit unions, and other lenders, and the individual loan originators who are employed by such entities.

Individuals working as loan originators for a mortgage broker business, like those employed by other entities, work closely with both borrowers and lenders, though representing neither, to obtain a mortgage loan for the customer. Though typically representing neither the borrower nor the lender in a given transaction, a loan originator may owe certain duties to his or her employer, a lender or an investor under the originator's contract with that person or entity. Similarly, a loan originator may also elect to enter into a separate written contract with a consumer, whereby that originator agrees to serve as the agent for that consumer and assume all of the duties and responsibilities associated with such a relationship.

Regardless of the specific duties that an individual loan originator chooses to assume, these individuals help borrowers through the complex mortgage origination process, and their services may include taking an application; performing a financial and credit evaluation; producing documents; working with realtors; ordering title searches, appraisals, and pay off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings. Because loan originators work with consumers throughout the entire mortgage origination process, the assistance individual originators provide often varies widely, depending on the nature of the transaction, the requirements of the customer, lender, or loan purchaser, and other factors.

Mortgage broker businesses ("mortgage brokers") are generally small businesses, employing between three and fifty employees. They serve both urban and rural communities of every size, and operate in all 50 states and the District of Columbia. Moreover, because many mortgage brokers are established and operated exclusively within the communities they serve, they add sustainable value to the origination process for both consumers and lenders by providing goods, facilities, and services with quantifiable value, including a loyal customer base and goodwill. Additionally, many mortgage brokers are able to serve communities and markets that are traditionally underserved by banks and other larger financial institutions.

A typical mortgage broker maintains business relationships with numerous lenders and investors, which allows the broker to provide consumers with access to multiple options for financing a home. Because of these relationships and the variety of financing options available through many mortgage lenders, brokers are often able to provide consumers a highly efficient and cost-effective method of obtaining a mortgage that satisfies the consumer's financial goals and circumstances. In fact, independent research has found that the mortgage broker model of origination, and the competition it creates among lenders and the brokers themselves, results in the most favorable pricing for borrowers.

A 2005 University study, undertaken without the support or knowledge of NAMB, examined "a large database estimated to include nearly half the subprime mortgage market" to determine "whether broker-originated mortgages are more costly to the borrower than lender-originated mortgages." This Mortgage Pricing Study, which is neither discussed nor cited in the Proposed Rule, found that "broker-originated mortgages are less costly to the borrower than lender-originated mortgages after holding other loan terms and borrower characteristics constant."[1] The Mortgage Pricing Study identifies several factors that may permit brokers to offer lower prices to prospective borrowers:

> Searching for loans through a broker, a borrower receives information on price and availability of credit from several lenders. Thus, a broker may reduce borrowers' search costs and enable borrowers to obtain lower cost credit than they could find themselves. Similarly, a broker dealing with several different lenders may be able to originate loans at a lower cost through economies of scale and specialization than a lender originating loans through a branch office. Moreover, by using many different brokers, a lender may be able to reach more borrowers than it could on its own.[2]

In addition, mortgage brokers characteristically are small businesses which operate with lean costs, and their lower overhead may confer pricing advantages relative to other mortgage originators. The Mortgage Pricing Study concludes:

> In sum, regardless of whether the possibility of borrower selection is taken into account, the evidence suggests that borrowers obtaining loans from brokers do not pay more and generally pay less than borrowers obtaining loans directly from lenders. The evidence supports the predictions of theoretical models of brokerage that brokers reduce the costs of matching borrowers. The evidence suggests that customers of brokers do not generally pay higher prices than customers of lenders and that any incentive to steer borrowers to higher priced loans is tempered by competition.[3]

Mortgage brokers do not act as representatives of either borrowers or lenders. Nor are mortgage brokers obligated under federal law by any fiduciary duty to borrowers to obtain the lowest rate or best possible price. Instead, prices are kept down, and the relative pricing advantage that mortgage brokers often confer upon consumers, results from the same dynamic that brings down price and improves quality for almost any other good or service: competition.

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[1] Amany El Anshasy (George Washington University), Gregory Ellihausen (Georgetown University) & Yoshiaki Shimazaki (Oklahoma State University), *The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders*, July 2005 ("Mortgage Pricing Study"), at 1, 12.
[2] Id. at 1.
[3] Id. at 12.

A December 2007 study by Richard Todd of the Federal Reserve Bank of Minneapolis and Professor Morris Kleiner of the Hubert Humphrey Institute of Public Affairs at the University of Minnesota also notes the beneficial role which mortgage brokers can have. This study presents data which strongly suggests that, by enhancing competition, mortgage brokers help consumers obtain better and more suitable mortgages at more favorable prices. The study observed: [B]rokers can make the complicated task of shopping and applying for the increasingly wide array of mortgage products more manageable and efficient for borrowers and lenders alike. Millions of households, including many affluent and sophisticated consumers, have arranged mortgages through brokers, frequently more than once. It seems likely that many if not most of them found value in the brokers' services, which is what we would expect in honest, competitive markets.[4]

This study further observed that in those states which have imposed particularly burdensome regulations on mortgage brokers, the number of brokers was relatively low. In turn, the study showed that a lower number of brokers often results in "negative consequences for many consumers," including "higher foreclosure rates, and a greater percentage of high-interest-rate mortgages."[5] Although the study refrained from concluding a causal link between the number of mortgage brokers in a market and favorable conditions for consumers, the study did conclude a clear statistical correlation existed between the two. Moreover, that correlation comports with basic economic axioms, as well as common sense: if consumers have greater choice among more vendors, and are given the tools to make informed choices about the relative merits of the products those vendors offer, consumers are certain to benefit.

C. How Mortgage Brokers & Loan Originators are Compensated

Loan originators, regardless of the type of entity they are or the type of entity they work for, are compensated in similar ways.

For example, mortgage broker businesses, like other competing entities, are compensated in consideration for their provision of goods, facilities, and services. Mortgage broker businesses may receive compensation directly from the borrower in the form of borrower-paid origination charges; from the lender or investor for the provision of goods and facilities, as well as the performance of an array of services; in the form of a yield-spread or service-release premium; or some combination thereof. The amount and type of compensation differs from one transaction to the next, and the compensation earned by mortgage broker businesses, like other entities, is used to offset net operating expenses and other costs associated with operating a small business.

Individual loan originators working for mortgage brokers, banks, credit unions, or other lenders are compensated in consideration of the services they provide to their employer. The amount and type of compensation will vary from one entity to the next, but may include a portion of the compensation paid to the entity directly by the borrower, a percentage of the yield-spread or service-release premium paid to the entity by a lender or investor, or some combination thereof.

Borrower-paid origination charges and lender or investor payments vary in type and amount depending on numerous factors, including consumer preferences, the size and complexity of the transaction, wholesaler requirements, and issues presented by either the borrower or the property securing the loan. Yield spread premium ("YSP") is determined by the amount a lender will pay to purchase a loan originated by a

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[4] Morris Kleiner & Richard Todd, *Mortgage Broker Regulations that Matter: Analyzing Earnings, Employment, and Outcomes for Consumers*, National Bureau of Economic Research Working Paper 13684 (December 2007)("Broker Regulations Analysis")© Morris M. Kleiner and Richard M. Todd, at 2-3.
[5] Id. at 1.

mortgage broker. Similarly, service release premium ("SRP") is determined by the amount an investor will pay to purchase a loan from a lender.

The amount that a lender or an investor will pay to purchase a loan, regardless of how the loan is originated, depends on the interest rate of the loan and the "par rate," or wholesale rate, established by said lender or investor. The wholesale rate is the interest rate at which the lender or investor will purchase the loan for a price equal to the face value of the loan. For example, a lender will pay a broker, or another lender, $100,000 to purchase a $100,000 loan originated at the wholesale rate. Lenders or investors may pay a premium above face value for a loan originated with an above wholesale interest rate. When paid to mortgage brokers, that premium is called YSP. When paid to a lender upon the sale of a loan, that premium is called SRP. The amount of the premium, which ultimately is a charge borne by the borrower, does not differ, regardless of the origination channel.

Significantly, the wholesale rate is not available to consumers because it does not include the costs of originating the loan. For this reason, it is important to note the difference between a wholesale "par rate" and a retail "par rate." A wholesale par rate is what a lender's branch or a mortgage broker must pay for the funds. All costs of origination and any profit must be added to the wholesale par rate to get a retail rate that is available to the consumer. It is not possible to offer a borrower the wholesale par rate, because lenders and mortgage brokers must provide for payment to the mortgage originator and net operating expenses. This incremental payment is not reflected in the wholesale rate. The wholesale rate is simply a metric for determining the price of a loan when it is resold in secondary markets. The retail par rate is the rate commonly available to borrowers without points or an origination fee. The price paid by consumers necessarily includes the costs of originating the loan.

YSP has existed from the time loan origination services expanded out of the savings and loans and the banking industry moved away from keeping loans in portfolio. Known by different terms over the years, YSP came to the forefront in 1992 because of a regulation issued by HUD implementing the RESPA.[6] That regulation required only mortgage broker transactions (those that do not fund and close loans in their name or those that table-fund) to disclose YSP on the Good Faith Estimate ("GFE") and again on the Uniform Settlement Statement ("HUD-1").

Today, an overwhelming number of loans are sold onto the secondary market and securitized immediately after origination. Therefore, in most instances, the traditional difference between broker and lender became a distinction without a difference: both originate loans and, in most cases, both sell loans more or less immediately. Nonetheless, the 1992 HUD regulation has created an artificial distinction between the YSP earned by those entities that "originate" transactions and the SRP, or gain-on-sale, which is earned by entities that "originate and fund" transactions and then sell the resulting loans. Because of this artificial and arbitrary distinction, today there is intense focus on YSP, but little understanding or discussion of the SRP or gain on sale. Nevertheless, prior to the 1992 HUD regulation, YSP and SRP were considered one in the same—indirect compensation paid to the originator of the loan by either the lender or the investor in return for services performed and the value of the loan. The lines now commonly drawn between these forms of compensation are based on industry jargon, not function.

YSP is a payment by a wholesaler to a retailer in a broker transaction in return for operating costs absorbed, services performed, closing costs financed, if applicable, and the value of the loan. SRP, or gain on sale, is what the lender, banker, or wholesaler receives as payment from the investor/secondary market—again, for costs absorbed, services performed, the financing of any closing costs, and the value of the loan. In today's market, the real difference that exists between SRP, gain on sale and YSP is that only YSP is disclosed. SRP and gain on sale is not disclosed anywhere, anytime.

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[6] 12 U.S.C. §2601-2617.

Yield spread premiums and service release premiums are not simply means of compensating mortgage originators. They also serve consumer interests by affording greater flexibility in structuring loans, and enhancing consumer choice. For example, YSP and SRP are how mortgage originators get paid for the loan origination services they perform when a consumer chooses to pay none, or only some of the origination fees or closing costs up front. These premiums are a legitimate and legal way for borrowers to forego paying their closing costs upfront and, instead, finance those costs through the interest rate. YSP and SRP finance those fees and costs, which results in the consumer paying a slightly higher interest rate.

No-cost and no-fee loans are offered widely by both mortgage broker and retail lender channels, and are made possible because of the YSP and SRP compensation structure. Thus, YSP is beneficial for many consumers who are ready to own a home but have to overcome the hurdle of significant down payments and closing costs, or for customers that choose to realize the savings of keeping their cash and financing their costs through their loan rate. Choosing to finance closing and origination costs through the rate allows borrowers to purchase and start building wealth through their home without requiring significant outlays of cash in addition to the downpayment at the outset of the loan. In addition, if consumers only had the choice to pay for those costs up front, it would take a noteworthy amount of time for the consumer to earn back those costs (on average 4-5 years), and statistics have shown that most loans are paid off earlier than that (through sale or refinancing).

YSP or SRP is also used to fund expenses which facilitate a mortgage transaction, but which neither the borrower nor lender is willing to bear. For example, mortgage originators often use YSP or SRP to pay for mortgage guaranty insurance, which, in a given transaction, may not be borne by either the borrower or lender. In such instances, the originator's net compensation is reduced accordingly.

In addition to YSP or SRP, mortgage originators also may earn compensation through affiliated business arrangements. Through those arrangements, originators may be paid for their role in a mortgage transaction by providers to whom title, tax, or flood service fees are paid; real estate and insurance agents; and builders. Those payments to the loan originator also may be passed through to the borrower, though neither current law nor the Proposed Rule specifically address such payments.

Although mortgage originators may be paid through multiple means, even in the same transaction, in practice, compensation tends to be sharply limited, by both legal restrictions[7] and competition. Loan originators operate in a competitive marketplace and must compete on service, product, and price. To be competitive, loan originators cannot simply increase their interest rate on a loan product in the face of very substantial competition. The internet, newspapers, TV ads and the sheer number of loan originators in the marketplace make it difficult for any originator to charge higher fees or rates than the market supports and still remain in business for any period of time.

Underwriting criteria also limits yield spreads, and thus the premiums paid for those spreads. Borrowers, particularly non-prime borrowers, may have trouble meeting increasingly rigorous underwriting standards. Therefore, there may be little room to adjust the rate on a loan without negatively impacting loan-to-value and debt-to-income ratios, among other underwriting factors, and causing the borrower to be disqualified for the loan sought.

D. How Mortgage Brokers & Loan Originators are Regulated

Mortgage brokers and loan originators are currently subject to extensive regulation at both the state and federal level. Traditionally state law has focused on the licensure, education and professional

[7] Several states already have high-cost loan restrictions and UDAP laws that limit compensation.

qualifications of individual loan originators and entities that are not otherwise supervised by a federal agency; while federal law has generally focused on regulating the transactions these individuals and entities are involved in. However, this dynamic changed somewhat in 2008, with the passage of the SAFE Act. The SAFE Act addressed, for the first time at the federal level, the issues of professional licensure, education and qualifications for individual loan originators.

1. Regulation at the State Level

The activities of brokers of all kinds, including residential mortgage brokers, are regulated in most states, either through laws that circumscribe broker conduct and dealings with clients, through state licensing regimes, or both. Currently, all 50 states and the District of Columbia license or otherwise regulate mortgage brokers specifically, and/or the activities of finding, placing, negotiating, or soliciting residential mortgage loans. These laws are designed to protect the public from the incompetence, fraud, misrepresentation, and/or dishonesty of those engaged in brokering loans. Additionally, as of January 1, 2010, the SAFE Act will require every state to have a system in place for the licensing and registration of all loan originators working for state-supervised entities, which includes mortgage brokers.

2. Regulation at the Federal Level

Federal law governs how loan originators relate to their customers and participate in real estate financing transactions. Traditionally, federal law has focused on how real estate transactions are conducted, not on the licensing or other regulation of individual loan originators. As noted above, however, this changed in 2008 with the passage of the SAFE Act as part of the Housing and Economic Recovery Act of 2008.

The SAFE Act was enacted to enhance consumer protection and reduce fraud by establishing minimum standards that every state must meet for the licensing and registration of state-licensed mortgage loan originators. The SAFE Act also directed the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR") to establish a nationwide mortgage licensing system and registry, and required every loan originator, regardless of whether they are licensed by a state or regulated by one of the federal banking agencies, to register and obtain a unique identifier within the system.

The SAFE Act provides clear evidence of Congress' belief that effective consumer protections must be put into place at the individual loan originator level. The SAFE Act also evidences Congress' intent that business entities, which are highly regulated and supervised at either the state of federal level, not be subject to unnecessary or duplicative oversight and regulation.

The Proposed Rule extends well beyond the boundaries of the traditional federal regulation of mortgage transactions, as well as the more recently expanded regulatory role that Congress dictated in the SAFE Act.

In addition to the SAFE Act, there are three other federal statutes that deal primarily with consumer protection and are most directly applicable to mortgage loan originators:

The Truth in Lending Act ("TILA"),[8] enacted in 1968, is designed to protect consumers in credit transactions by requiring clear disclosure of key terms of the lending arrangement, as well as all costs associated with the transaction. Accordingly, the statute requires lenders to provide a Truth in Lending Statement to borrowers in a prescribed form which factors in numerous costs relating to the transaction, including compensation of mortgage brokers. TILA is administered by the Board.

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[8] 15 U.S.C. §1601-1667f.

The Home Ownership and Equity Protection Act ("HOEPA"),[9] enacted in 1994, amended TILA and imposed additional disclosure requirements on creditors for certain high-cost loans. HOEPA, like TILA, is subject to the Board's jurisdiction.

The Real Estate Settlement Procedures Act ("RESPA"),[10] enacted in 1974, aims to prevent lenders from imposing excessive or abusive settlement charges on borrowers upon closure of any federally-related mortgage loan. To that end, RESPA requires lenders to provide borrowers a GFE which lists all charges, including broker fees, related to settlement of the transaction. Under most circumstances, the GFE must be presented within three days of application to permit comparative shopping. In addition, settlement costs must again be disclosed at closing on the HUD-1. The U.S. Department of Housing and Urban Development ("HUD") is charged with implementing RESPA. Through regulations and policy statements issued under this authority, HUD currently requires the disclosure of yield spread premiums on the GFE and the HUD-1. No such obligation is imposed with respect to SRP paid to lenders and shared with lenders' employees through bonuses, overages, commissions, or other incentives.

The Proposed Rule is necessarily limited to matters within the Board's jurisdiction. Therefore, the Proposed Rule only amends Regulation Z, which is the implementing regulation for TILA and HOEPA. However, in the Proposed Rule the Board "recognizes that HUD has issued policy statements regarding creditor payments to mortgage brokers under RESPA and guidance as to disclosure of such payments on the GFE and HUD–1 Settlement Statement. HUD also has published revised disclosures for broker compensation under RESPA to become effective January 1, 2010."[11] The Proposed Rule further states that the Board intends that its proposal would complement HUD's final rule. The proposed provision regarding creditor payments to loan originators is intended to be consistent with HUD's existing guidance regarding broker compensation under Section 8 of RESPA.[12]

III. Changes in the Market Since the Board Began its Review of Regulation Z

According to the Proposed Rule, the Board began its current review of Regulation Z in December 2004. Since that time, our mortgage, housing, and financial markets have endured tremendous turmoil and significant changes.

As noted above, there has been a fundamental shift in our understanding and acceptance of what truly lay at the root of the crisis which continues to wreak havoc on consumers, industry participants and our economy. In the very early stages of this crisis, around the time the Board began contemplating revisions to the rules for closed-end credit, it was a commonly held belief that all mortgage problems were the result of reckless subprime lending and aggressive speculation in risky housing markets.

Today, after witnessing the collapse, or near-collapse, of many of our nation's largest financial institutions, it has become clear that subprime lending, aggressive pricing and incentivization at all levels were only part of far more extensive problems. Recent developments have brought to light the reality that the policies, practices, and behaviors which contributed to this crisis were not limited to origination channels. Rather, it was a confluence of the policies and practices in all phases of the mortgage market that precipitated the issues the Board is attempting to address in the Proposed Rule.

[9] 15 U.S.C. §1602(aa), 1639.
[10] 12 U.S.C. §§ 2601–2617.
[11] 74 Fed. Reg. at 43320.
[12] Id.

Financial innovation reached unprecedented levels over the past decade. Lenders, borrowers, investors, and regulators became increasingly overconfident in the security and effectiveness of new and sometimes exotic financial products that promised to bring wealth and prosperity while minimizing risk.

At the same time, underwriting standards for mortgage loans were significantly relaxed and greater emphasis was placed on home valuation as opposed to other factors traditionally used to determine a borrower's likelihood of repaying a loan. With home prices steadily rising, borrowers seized upon this opportunity to take out increasingly larger mortgages with little to no downpayment required and less stringent qualifying documentation requirements. As a result, millions of Americans obtained loans that many would subsequently be unable to afford due to rate increases, job loss, unexpected additional expenses, and other factors.

Lenders, investors, regulators, and homeowners all took comfort in the belief, however misguided, that property values would only rise, and a good number of people were able to get rich relatively quickly. Unfortunately, however, this only made everyone involved hungry for more.

Builders and real estate agents were clamoring to sell properties as home values skyrocketed. At the same time, banks and lenders, who were effectively assuming the role of middle-men, further relaxed underwriting standards and incentivized loan officers and brokers to originate more loans, which the lenders would then quickly absolve themselves of responsibility for by passing them off to Wall Street investors.

For its part, Wall Street was buying millions of mortgage loans, good and bad, from lenders all across the country and chopping them up in order to repackage them as complex investment securities. Wall Street would then turn around and offer these securities for sale to banks, pension funds, and countless other investors worldwide. Despite the fact that virtually no one understood what these security instruments were made up of or how they were going to behave, rating agencies proceeded to certify them as "AAA," and Wall Street firms made billions of dollars from their sale to domestic and international investors clamoring for their share of profits from the booming U.S. real estate market.

As was noted in a New York Times Editorial earlier this year, "the unfolding evidence makes clear that this was a systemic problem, driven by Wall Street's insatiable appetite for mortgage backed securities."[13] Many experts agree, and identify these security instruments, which were created by Wall Street, propped-up by rating agencies, and gobbled-up by investors, as being at the heart of our current financial crisis.[14]

Had housing prices continued to rise, we may never have fully realized the risk presented by all of this unchecked financial innovation. However, when the housing bubble finally burst, it set into motion a chain reaction of events that crippled our mortgage and housing markets. Homeowners began defaulting on their mortgages when their interest rates adjusted upward or their overall financial circumstances changed, and the value of their home was no longer sufficient to cover the cost of refinancing. This led to a rise in foreclosures and a glut of homes on the market, which served to further depress housing prices, and in turn led to even more defaults and foreclosures.

The rapidly increasing number of mortgage defaults and foreclosures naturally led to the failure of the high-risk mortgage-backed securities sold on Wall Street, which prompted many investors to try to cover their losses by calling-in credit default swaps they had purchased to protect themselves from precisely this occurrence. However, the large investment banks responsible for creating the mortgage-backed securities and peddling the credit default swaps had never set aside sufficient capital to cover their obligations

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[13] Editorial: Common Sense in Lending, NY Times, March 8, 2009.
[14] *60 Minutes: A Look at Wall Street's Shadow Market* (CBS News television broadcast, October 5, 2008).

should those "insurance policies" be called-in. As a result, it became increasingly impossible for these institutions to extend credit to borrowers or shield their tremendous financial losses from regulators and investors, ultimately forcing many of these institutions out of the industry.

In addition to the market turmoil that dramatically changed the face of the mortgage and housing industry over the past several years, a great deal of change has also been affected through legislative and regulatory action.

In 2007, the Board began proposing revisions to the rules for closed-end credit in several phases. First, the Board proposed rules under HOEPA for high-cost mortgage loans ("2007 HOEPA Proposed Rule"). These rules were finalized in July 2008 ("2008 HOEPA Final Rule"), and prohibited certain unfair or deceptive lending and servicing practices in connection with closed-end mortgages. These rules also revised the advertising rules for both closed-end and open-end home-secured loans, to ensure that advertisements contain accurate and balanced information and do not contain misleading or deceptive representations.

Additionally, the Board earlier this year approved final rules implementing the Mortgage Disclosure Improvement Act ("MDIA").[15] As discussed in greater detail below, the MDIA supplements the requirements of the 2008 HOEPA Final Rule with regard to transaction-specific disclosures by, among other things, requiring early disclosures for mortgage loans secured by dwellings even when the dwelling is not the consumer's principal dwelling, and by requiring waiting periods between the time when disclosures are given and consummation of the transaction.[16]

In 2008, HUD proposed and finalized long-awaited revisions to Regulation X under RESPA ("2008 RESPA Final Rule"). These revisions, which take effect January 1, 2010, require loan originators to provide consumers with a standard GFE that the agency believes clearly discloses key loan terms and closing costs.

Also in 2008, Congress enacted the SAFE Act as part of the Housing and Economic Recovery Act. The SAFE Act, for the first time, established within the law the concept of "loan originators." The term loan originator is defined as any individual who takes a residential mortgage loan application, and offers or negotiates terms of a residential mortgage loan for compensation or gain.[17]

In addition to creating this category of individual within the mortgage industry, the SAFE Act established minimum standards that loan originators in every state must satisfy and a nationwide licensing and registration system for all loan originators. Under this system, all loan originators, regardless of whether they are state or federally-regulated, are required to submit fingerprints to the FBI, and any other governmental agency or entity authorized to receive such information for a state and national criminal background check, and must obtain a unique identifier through the Nationwide Mortgage Licensing System and Registry administered by CSBS and AARMR. Additionally, all state-licensed loan originators are required to meet minimum education and testing standards.

The SAFE Act aims to prevent unqualified individuals from entering or remaining in the mortgage origination industry and achieve uniformity and a higher level of professionalism for those individuals working closely with consumers. NAMB was a strong supporter of the SAFE Act, and has long

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[15] The MDIA is contained in Sections 2501 through 2503 of the Housing and Economic Recovery Act of 2008, Pub. L. 110–289, enacted on July 30, 2008. The MDIA was later amended by the Emergency Economic Stabilization Act of 2008, Pub. L. 110–343, enacted on October 3, 2008.
[16] 74 Fed. Reg. 23289.
[17] 12 U.S.C. §5102(3)(A)(i).

advocated for measures that would create and preserve a professional, highly educated and uniformly regulated originator workforce. Although the SAFE Act will not fully take effect in every state until January 1, 2010, there is evidence showing it has already had a profound effect, as it is estimated that nearly 2/3 of the loan originators working in the industry in 2006 are no longer originating loans.

Finally, Congress is currently working on additional legislation to comprehensively address the issue of consumer protection in the mortgage marketplace.

IV. Principles that Should Guide Proposed Reforms

Any policy initiatives to be implemented by the Board or any other governmental entity must, above all else, meet two criteria.

First, the governmental entity must identify and articulate the proper policy goals. These goals should be identified through a careful analysis of how consumers are currently served by mortgage markets, and by positing what systemic traits those markets should have to ensure that consumers' are best protected.

Second, the governmental entity must consider a full range of alternative means to achieve the articulated policy goals, and subject each of those possible alternatives to rigorous scrutiny to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, the agency should carefully consider data and quantifiable evidence, produced by other government agencies with particular expertise in the subject area and independent academic researchers whose backgrounds permit them to make an informed and disinterested assessment of the relevant facts.

As detailed below, NAMB believes that the Proposed Rule meets these two criteria in certain respects, but fails to do so in others.

V. The Proposed Rule

A. Overview

On August 26, 2009, the Board issued the Proposed Rule to amend Regulation Z, which implements TILA. The Proposed Rule would apply to all closed-end credit transactions secured by real property or a dwelling, and would not be limited to those transactions secured by a consumer's principal dwelling. The Proposed Rule has two principal components.

First, the Proposed Rule would change the format, timing and content of disclosures for the four main types of closed-end credit information governed by Regulation Z, including (1) disclosures at application; (2) disclosures within three days after application; (3) disclosures three days before consummation; and (4) disclosures after consummation.

Second, the Proposed Rule would limit loan originator compensation for all closed-end mortgage transactions by prohibiting certain payments to mortgage brokers or loan officers that are based upon a loan's terms or conditions. The Proposed Rule would also prohibit mortgage brokers or loan officers from "steering" consumers toward transactions that are not in the consumer's interest in order for the mortgage broker or loan officer to increase his or her compensation.

B. Goals of the Proposed Rule

The Board states that its proposed amendments to Regulation Z are designed to achieve three goals: (1)

revise the disclosures required for closed-end mortgage loans; (2) restrict certain loan originator compensation practices for mortgage loans; and (3) require disclosures for closed-end mortgage loans to be provided earlier in the transaction and additional post-consummation disclosures for certain changes in terms.

While NAMB applauds the Board for its continued efforts to address the problems that exist in our mortgage market, NAMB believes that the Board's goals to simplify and clarify disclosures for consumers and prohibit steering are not successfully accomplished through the proposed changes to Regulation Z. In fact, NAMB believes that the changes, as proposed, fail to achieve those goals and actually contradict their overall purpose.

The proposed amendments to Regulation Z make the entire mortgage process more complex for borrowers, exacerbate and compound the already complicated practices that exist, and most importantly, eliminate consumer choice. NAMB most strongly objects to the Board's second stated goal of restricting loan originator compensation practices. NAMB shares the Board's resolute commitment to consumer protection; however, NAMB is deeply concerned that the Board's proposal will ultimately fail both consumers and the mortgage market.

For reasons we discuss at great length below, the Board's vaguely stated goal of restricting loan originator compensation practices falls outside of its regulatory authority under HOEPA, and unfairly and disproportionately impacts small businesses competing in the market for origination services. Therefore, NAMB respectfully recommends that the Board withdraw the proposed amendments, perform more qualified consumer testing (utilizing the results in an effective manner), and engage and confer with seasoned, knowledgeable industry experts to obtain credible and useful insights and information, thereby ensuring a more successful and effective proposal that will properly achieve the Board's objectives.

C. MDIA Amendments to TILA

On July 30, 2008, Congress enacted the Mortgage Disclosure Improvement Act ("MDIA") as part of the Housing and Economic Recovery Act of 2008. The MDIA was later amended by the Emergency Economic Stabilization Act of 2008. The MDIA broadened the requirements of TILA and codified some of the requirements of the Board's 2008 HOEPA Final Rule.

The MDIA expands coverage of the early disclosure requirement under TILA to include loans secured by a dwelling even when it is not the consumer's principal dwelling and require waiting periods between the time when disclosures are made and the ultimate consummation of the mortgage transaction. The MDIA also requires transaction-specific disclosures to be provided within three business days after an application is received and before the consumer pays a fee, other than a fee for obtaining the consumer's credit history. If the annual percentage rate ("APR") on the early TILA disclosure exceeds a certain tolerance before consummation, MDIA requires the creditor to provide a corrected disclosure that the consumer must receive at least three days before consummation. If any term other than the APR becomes inaccurate after early disclosure is made, the creditor is required to provide the consumer a corrected disclosure no later than the date of consummation.

The Board implemented the MDIA requirements in final rules that were published May 19, 2009, and became effective July 30, 2009.

With the MDIA amendments to TILA in effect for nearly five months, there is increasing anecdotal evidence that creditor interpretations of the new requirements vary widely and are actually increasing costs for consumers, unnecessarily delaying closings, and serving as an obstacle to consumers shopping through their mortgage broker for a better rate once application has been made to a particular lender.

For example, the APR triggers for re-disclosure continue to lack clarity. Some lenders interpret the rules as requiring re-disclosure whenever the APR changes by .125%, regardless of whether the change makes the APR higher or lower than originally disclosed. Other lenders will only provide the borrower with a new disclosure when the APR rises by .125%, not when the APR goes down. The requirements for re-disclosure and the timing of such disclosures under MDIA is requiring many consumers to incur additional costs of .125-.25% to extend rate-lock periods so that creditors may remain compliant with MDIA, even in cases where the re-disclosure is triggered by a decrease in the borrower's interest rate or points on the loan.

Additionally, because MDIA prohibits charging the borrower any fee, other than to obtain a credit report, prior to receipt of the early TILA disclosures, consumers are being discouraged from shopping for a better rate or more favorable loan terms after they or their mortgage broker have submitted an application to a lender. For example, a borrower completes an application with a mortgage broker, and that broker submits the borrower's application to Lender A. Lender A provides the required early TILA disclosures and orders an appraisal for which the consumer is charged. Interest rates improve and the mortgage broker sees that the borrower could obtain the same loan with a more favorable rate and/or terms from Lender B. If the borrower chooses to obtain the loan from Lender B, that borrower will be forced to begin the process anew with Lender B and will be forced to pay an additional $350-500 for Lender B's new appraisal. This is because Lender B would be out of compliance with MDIA if they were to accept transfer of the appraisal ordered by Lender A, since under such circumstances the borrower would have been charged a fee for the appraisal prior to receiving Lender B's early TILA disclosures.

One of the purposes of TILA is to provide meaningful disclosure of credit terms to enable consumers to compare credit terms available in the marketplace more readily and avoid the uninformed use of credit. The timing of the TILA disclosures required under MDIA has already created substantial confusion in the marketplace and among creditors, and NAMB is concerned that pressing forward with new rules that do not adequately address the issues created by the most recent revisions to TILA will prove to be counter productive and actually subvert the intended purposes of the statute.

To better serve borrowers, a change should be made to the rules implementing MDIA. As with RESPA, the initial disclosures required under MDIA should be provided by the originator, on behalf of any creditor who subsequently accepts the loan. This provides greater protection for the consumer, and making this change to the MDIA rules would solve the issue of appraisal portability.

D. Coordination with Disclosures Required Under RESPA

RESPA, which is implemented by HUD through Regulation X, seeks to ensure that consumers are provided with timely information about the nature and costs of the settlement process and are protected from unnecessarily high real estate settlement charges. RESPA mandates disclosure of various settlement costs associated with RESPA-covered mortgage transactions, and prohibits certain practices in connection with covered transactions.

Among other things, RESPA requires creditors to provide a GFE of settlement costs to borrowers within three business days after the borrower submits a written application. This time period coincides with the early disclosures currently required under TILA. The revised TILA disclosures required under the Proposed Rule would include the total settlement charges that appear on the GFE as mandated by RESPA. According to the Proposed Rule, the total settlement charges would be added to the TILA form because consumer testing conducted by the Board found that consumers wanted to have settlement charges disclosed on the TILA form.

Although the two statutes serve different purposes, RESPA and TILA, both currently and under the Proposed Rule, have considerable overlap. Harmonizing the two disclosure schemes and ensuring they are compatible and complimentary is a stated goal of the Board in its Proposed Rule. NAMB strongly believes that this is an important goal and supports the Board's efforts to coordinate the disclosures required under RESPA and TILA.

However, NAMB does not believe the Proposed Rule evidences sufficient coordination to date between the Board and HUD with regard to these disclosure regimes.

Despite the Board's efforts to harmonize TILA and RESPA disclosures through the Proposed Rule, there remain distinct and significant differences, and even some conflict, between what's required under each regulation.

For instance, effective January 1, 2010, RESPA Regulation X provides that the sum of most lender-required third party settlement costs may vary no more than 10% from the same costs disclosed on the GFE. Certain other changes, such as the lender's origination fee, cannot vary, unless the consumer did not lock the interest rate. By permitting up to a 10% variance on certain costs that were disclosed earlier in the transaction, HUD allows for changed circumstances at closing on a limited basis. The revised TILA disclosures under the Proposed Rule include no similar tolerances. Instead, the Proposed Rule requires continual re-disclosure anytime there is a change in fees charged to the borrower between initial disclosure and consummation of the loan.

Compounding this particular problem, TILA disclosures required under the Proposed Rule would be required to include the total settlement costs disclosed on the GFE and HUD-1 settlement statement under RESPA. RESPA permits final settlement charges to be disclosed on the date the transaction is consummated. Thus, under RESPA, creditors, settlement agents, and settlement service providers have until the date of consummation to determine the final amounts of the various settlement costs. As proposed, the revised final TILA disclosures, while required to include the total settlement charges disclosed under RESPA, would have to be made earlier than the final HUD disclosures – at least three business days prior to consummation, or as many as seven business days if the creditor mails the disclosures.

The Board states in its Proposed Rule that it recognizes requiring loan terms and costs to be finalized several days before consummation would require significant changes to current settlement practices, and that these changes would generate costs that creditors and third-party service providers would pass on to consumers.

NAMB is concerned about just how expensive and damaging this would prove to be for consumers. NAMB is also concerned that this additional expense would come as a result of somewhat illusory protection for the consumer, since receiving final disclosure of APR and finance charges three to seven days before closing will rarely affect a consumer's decision to proceed to consummation of the purchase of a home. Considering an average rate lock period of 30 days, it can be fairly stated that much of that time is spent waiting for various disclosures. Some estimate that this adds up to approximately .375% of the cost of every mortgage or billions of dollars every year being borne by consumers.

E. Consumer Testing

A stated goal for the Board's Regulation Z review and revision is to produce revised and improved mortgage disclosures that will more likely be used and understood by consumers during the mortgage shopping and decision-making processes.

The Proposed Rule explains in detail the process by which the Board, beginning in 2007, retained and worked with a research and consulting firm – ICF Macro – that specializes in designing and testing documents to conduct consumer testing of revised disclosures. ICF Macro, in concert with the Board, conducted several tests in different cities throughout the United States. The testing consisted of four focus groups and eleven rounds of one-on-one cognitive interviews. The goals of these focus groups and interviews were to learn how consumers shop for mortgages and what information consumers read when they receive mortgage disclosures, and to assess their understanding of such disclosures.

The consumer testing groups included participants with a range of ethnicities, ages, educational levels, and mortgage behaviors, including first-time mortgage shoppers, prime and subprime borrowers, and consumers who had obtained one or more closed-end mortgages. For each round of testing, ICF Macro developed a set of model disclosure forms to be tested. Interview participants were asked to review model forms and provide their reactions, and were then asked a series of questions designed to test their understanding of the content. Data was collected on which elements and features of each form were most successful in providing information clearly and effectively. The findings from each round of interviews were incorporated in revisions to the model forms for the following round of testing.

Specifically, the Board worked with ICF Macro to develop and test several types of closed-end disclosures, including: (i) two Board publications to be provided at application, entitled “Key Questions to Ask about Your Mortgage” and “Fixed vs. Adjustable Rate Mortgages”; (ii) an ARM loan program disclosure to be provided at application; (iii) an early TILA disclosure to be provided within three business days of application, and again so that the consumer receives it at least three business days before consummation; (iv) an ARM adjustment notice to be provided after consummation; and (v) a payment option monthly statement to be provided after consummation.

The results of the Board’s testing indicated that many consumers do not shop for a lender or a mortgage. Several participants revealed that they were referred to a lender by a realtor, family member or friend, and that they relied on that lender to get them a loan. Consumers who did report shopping for a mortgage indicated that much of the information in the current TILA disclosure was of secondary importance to them when considering a loan. Instead, these testing participants indicated that they relied primarily on originators’ oral quotes for interest rates, monthly payments, and closing costs. Consumers reported that they looked for the contract rate of interest, monthly payment, and in some cases, closing costs, and most participants assumed that the APR was the contract rate of interest, and that the finance charge was the total of all interest they would pay if they kept the loan to maturity. Additionally, when asked to compare two loan offers using redesigned model forms that contained revised disclosures, few participants used the APR and finance charge to compare the loans. Most consumers also revealed that once they had applied for a particular loan and received a TILA disclosure they discontinued any shopping that they may have previously engaged in.

According to the Board, these findings suggest that consumers need information early in the process, and that information should not be limited to information about ARMs. As a result, in its Proposed Rule, the Board seeks to require creditors to provide key information about evaluating loan terms beginning at the time an application form is provided to the consumer.

It seems clear that the Board’s consumer testing revealed numerous problems with the current disclosures required under TILA. To that end, the Board acknowledges in the Proposed Rule that its consumer testing indicated that borrowers do not use the current TILA disclosures properly, if they use them at all. Additionally, the Board states in the Proposed Rule that “[c]onsumer testing suggests that consumers find the finance charge and APR disclosure confusing and unhelpful when shopping for a mortgage.”

Nevertheless, the Board's response to these findings includes requiring the APR to be disclosed more prominently, and requiring creditors to make additional and earlier disclosures to consumers.

F. Board's Rulemaking Authority

The Truth in Lending Act ("TILA") was enacted in 1968, for the purpose of assuring meaningful disclosure of credit terms so that consumers would be able to compare more readily the various credit terms available and avoid the uninformed use of credit. TILA delegates broad authority to the Board to promulgate regulations necessary to effectuate the purposes of the Act.

Specifically, TILA directs the Board to publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements of the act and to aid borrowers in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures. TILA also authorizes the Board to issue regulations that contain such classifications, differentiations, or other provisions, or that provide for such adjustments and exceptions for any class of transactions, that in the Board's judgment are necessary or proper to effectuate the purposes of the act, facilitate compliance with the act, or prevent circumvention or evasion of the act.

In 1994, HOEPA was enacted to amend TILA. Among other things, the HOEPA amendments granted the Board authority to proscribe certain practices with regard to all mortgage loans. Specifically, the statute states:

> The Board, by regulation or order, shall prohibit acts or practices in connection with –
>
> (A) mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of this section; and
>
> (B) refinancing of mortgage loans that the Board finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower.[18]

The authority granted to the Board under Section 129(l)(2) is broad, but not unlimited. TILA, as amended by HOEPA, does not set forth a standard for what is unfair or deceptive. In fact, the Conference Report for HOEPA indicates that, in determining whether a practice in connection with mortgage loans is unfair or deceptive, the Board should look to the standards employed for interpreting state unfair and deceptive trade practices statutes and the Federal Trade Commission Act ("FTC Act"), Section 5(a).[19] Accordingly, the Proposed Rule states that, "[I]n determining whether a practice in connection with mortgage loans is unfair or deceptive, the Board should look to the standards employed for interpreting state unfair and deceptive trade practices under the Federal Trade Commission Act."[20]

Under the FTC Act, an act or practice is unfair when it causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In addition, in determining whether an act or practice is unfair, the FTC is permitted to consider established public policies, but public policy considerations may not serve as the primary basis for an unfairness determination. The FTC has

[18] 15 U.S.C. §1639
[19] H.R. Rep. 103-652, at 162 (1994) (Conf. Rep.)
[20] 74 Fed. Reg. at 43237

interpreted these standards to mean that consumer injury is the central focus of any inquiry regarding unfairness.

Consumer injury may be deemed substantial if it imposes a small harm on a large number of consumers, or if it raises a significant risk of concrete harm. The FTC looks to whether an act or practice is injurious in its net effects. The FTC has also observed that an unfair act or practice will almost always reflect a market failure or market imperfection that prevents the forces of supply and demand from maximizing benefits and minimizing costs. In evaluating unfairness, the FTC looks to whether consumers' free market decisions are unjustifiably hindered.

The FTC has also adopted standards for determining whether an act or practice is deceptive (though these standards, unlike unfairness standards, have not been incorporated into the FTC Act). First, there must be a representation, omission or practice that is likely to mislead the consumer. Second, the act or practice is examined from the perspective of a consumer acting reasonably in the circumstances. Third, the representation, omission, or practice must be material. That is, it must be likely to affect the consumer's conduct or decision with regard to a product or service.

G. Major Proposed Revisions

1. Pre-Application Disclosures

Currently, Regulation Z only requires pre-application disclosures for variable-rate transactions. Creditors are required to provide consumers with the Consumer Handbook on Adjustable Rate Mortgages ("CHARM Booklet") and an ARM loan program disclosure. The current ARM loan program disclosure must include the index and margin used to calculate the interest rates and payments, and either a 15 year historical example of rates and payments for a hypothetical $10,000 loan or the maximum rate and payment information for a hypothetical $10,000 loan originated at the interest rate in effect at the time the disclosure is made.

The Proposed Rule would require pre-application disclosures to be made exclusively by creditors, and such disclosures would be required on all closed-end loan transactions secured by real property or a dwelling, regardless of whether a consumer is seeking a fixed or adjustable-rate mortgage. Specifically, creditors would be required to provide consumers with two new Board publications, in addition to a revised ARM loan program disclosure.

The Proposed Rule would also require creditors to provide consumers with a one-page Board publication entitled "Key Questions to Ask about Your Mortgage," before the consumer applies for a loan or pays a nonrefundable fee, whichever is earlier. This publication would describe potentially risky features of a mortgage to consumers in a plain-English question and answer format.

Additionally, in lieu of the Board's CHARM Booklet, the Proposed Rule would require creditors to provide consumers with an additional one-page Board publication entitled "Fixed vs. Adjustable Rate Mortgages." This publication would attempt to explain the basic differences between fixed and adjustable-rate mortgages.

Finally, the Proposed Rule would attempt to simplify the current ARM loan program disclosure by focusing more on the interest rate and payments, as well as the potential risks associated with ARM loans. The proposed ARM loan program disclosure would be provided in tabular, question and answer format.

NAMB supports the Board's efforts provide consumers with important information about mortgages early in the process. However, because the Proposed Rule specifically and exclusively requires creditors to make these pre-application disclosures and fails to account for the fact that mortgage brokers and other third-party originators are often the ones making first contact with consumers and taking applications, the Proposed Rule poses a compliance problem for creditors, as well as these other entities. Specifically, mortgage brokers and other third-party originators would no longer be able to take mortgage applications because these entities are not defined as creditors, and therefore cannot make the necessary pre-application disclosures as required by the Proposed Rule. NAMB recommends revising the language of the Proposed Rule to permit either the creditor, or a mortgage broker or other third-party originator, to provide the required pre-application disclosures.

2. Early TILA Disclosures – Within Three Days after Application

TILA and Regulation Z currently require creditors to provide an early TILA disclosure within three business days following application and at least seven business days prior to consummation of the loan. If the APR on the early TILA disclosure exceeds a certain tolerance before consummation, the creditor must provide corrected disclosures that the consumer must receive at least three days before consummation. If any term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than the date of consummation.

The early TILA disclosure, and any corrected disclosure, must include certain loan information, including the amount financed, the finance charge, the APR, the total of payments, and the amount and timing of payments.

a. Calculation of the Finance Charge

The term finance charge is defined in TILA as "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." Other fees and charges are excluded from the calculation of the finance charge. The finance charge is meant to be a single dollar figure amount representing the total cost of credit to the consumer. The finance charge is used in calculating the APR for the loan as well.

The Proposed Rule would revise the manner in which the finance charge is calculated, as well as the disclosure of the finance charge and the APR. The Proposed Rule would maintain TILA's definition of a finance charge as a fee or charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to the extension of credit. However, the Proposed Rule would eliminate the "some fees in, some fees out" approach currently used to calculate the finance charge.

Under the Proposed Rule, the finance charge would include all charges by third parties that the creditor requires the use of as a condition of, or incident to, the extension of credit. The finance charge would also include all fees charged by a mortgage broker, including those paid directly by the consumer and those paid the creditor, regardless of whether the creditor requires the use of the mortgage broker as a condition of, or incident to, the extension of credit.

NAMB is supportive of the concept of an "all in" approach to calculating the finance charge as outlined in the Proposed Rule. NAMB believes this approach may be a better alternative than the current "some fees in, some fees out" calculation because it would capture all of the borrower-paid expenses in the transaction. Nevertheless, NAMB is concerned about two particular aspects of the new finance charge calculation under the Proposed Rule.

First, mortgage broker fees that are paid by the creditor should not be included in the calculation of the finance charge. Although these fees are indirectly being paid by the consumer incident to the extension of credit, such charges have already been factored in through the note rate of the loan. Including mortgage broker fees paid by the creditor in a calculation of the finance charge will effectively double-count these fees in the APR and result in an artificially inflated APR in mortgage broker transactions.

Second, exemptions should be made for smaller loan amounts so that these loans are not inadvertently captured by the higher-priced loan thresholds under HOEPA. Because some borrower-paid fees (*i.e.*, appraisal fees, survey fees, closing fees, lender administrative fees, etc.) are charged as flat dollar amounts and not a percentage of the loan amount, the "all in" approach to calculating the finance charge under the Proposed Rule will trigger violations of the higher-priced loan thresholds under HOEPA on virtually every transaction involving a smaller loan amount.

b. <u>Disclosure of the Finance Charge and APR</u>

Currently, TILA requires that a loan's finance charge and APR be disclosed more conspicuously than other information included in the disclosures. The Proposed Rule contains a number of revisions to the format and content of TILA disclosures in an effort to make them clearer. For example, the term finance charge would be replaced with "interest and settlement charges," and the disclosure would no longer be more conspicuous than other required disclosures. Additionally, creditors would be required to summarize key loan terms and highlight interest rate and payment information in a table format, and disclose APR in 16-point font in close proximity to a graph that compares the consumer's APR to the HOEPA Average Prime Offer Rate for borrowers with excellent credit and the HOEPA threshold for higher-priced loans. The Board believes that such disclosure would put the APR in context and help consumers understand whether they are being offered a loan that comports with their creditworthiness.

NAMB supports efforts to provide clearer and more conspicuous consumer disclosures. However, NAMB strongly believes that the Board should eliminate the APR comparison graph in the Proposed Rule, as it could be highly misleading and is unlikely to provide any real benefit to consumers with regard to shopping or understanding the terms of their loan. The chief problem with the APR comparison chart is that it is comparing note rate quotes (*i.e.*, the Freddie Mac Prime Market Mortgage Survey) to APR, which includes not only the finance charges, but also any loan level price adjustments ("LLPAs") and interest rate risk borne by the lender to guarantee the terms offered for a certain period of time (*i.e.*, rate lock). This is an "apples to oranges" comparison, and will only lead to greater confusion and distrust of the mortgage shopping process by consumers.

3. Final TILA Disclosures – Three Days before Consummation

As noted above, TILA requires creditors to provide early disclosures to consumers within three business days after receiving the consumer's written application and at least seven business days before consummation. If the APR on the early TILA disclosure exceeds a certain tolerance before consummation, the creditor must provide corrected disclosures that the consumer must receive at least three days before consummation. If any term other than the APR becomes inaccurate, the creditor must give the corrected disclosure no later than at consummation.

The Proposed Rule would require creditors to provide consumers a final TILA disclosure at least three business days before consummation, regardless of whether any terms have changed since the early disclosure was provided. Additionally, the Proposed Rule presents two alternative approaches for disclosing changes to loan terms and settlement charges that occur during the three business day waiting period required between receipt of the final disclosures and the consummation date.

Under the first approach, if any terms change during the three business day waiting period the creditor would be required to provide another final TILA disclosure and delay consummation of the transaction by an additional three business days. Alternatively, the second approach would require creditors to provide another final TILA disclosure if there is any change in terms, but the additional three business day waiting period would be waived, so long as any change to the APR does not exceed a designated tolerance and the creditor does not add any adjustable-rate feature to the loan.

NAMB strongly encourages the Board to reject the first alternative approach described above. If the final TILA disclosures are required to be precise and unchanging, the disclosure cycle could continue on perpetually without ever reaching consummation of the transaction. Each time a closing date is changed, the per diem interest and finance charge would have to be recalculated and another closing date would have to be scheduled.

NAMB supports the second alternative approach where a tolerance threshold would be established within which certain terms could change and be re-disclosed without triggering an additional waiting period. Including some tolerance in the proposed final TILA disclosure requirements would be beneficial for lenders, allowing for some flexibility, and will reduce the likelihood of potential litigation between real estate buyers and sellers where a series of mandatory re-disclosures preventing the sale from closing could result in breach of contract by the buyer.

4. Definition of Loan Originator & Mortgage Broker

The Board is proposing to prohibit certain payments to loan originators that are based on the terms or conditions associated with the transaction. The Board is also proposing to prohibit loan originators from steering consumers to transactions that are not in the consumer's interest in order to increase the originator's compensation. Accordingly, the Board proposes to amend Regulation Z to provide a definition of "loan originator," which would include persons who are covered by the current definition of mortgage broker but also would include employees of the creditor, who are not considered "mortgage brokers."[21]

The term "mortgage broker" is already defined in §226.36(a) of Regulation Z, because mortgage brokers are subject to the prohibition on coercion of appraisers in §226.36(b). The Proposed Rule does not intend to substantively change the definition of mortgage broker. Rather, the Board merely seeks to define the term "loan originator," and ensure that mortgage brokers, as defined under TILA, are included in the definition of loan originator.

As discussed above, the term "loan originator" is already defined by Congress under the SAFE Act. Additionally, all 50 states have redefined, or are in the process of redefining, the term loan originator in their statutes and regulations to reflect the definition created by Congress. In the Proposed Rule, the Board seeks to change this statutory definition, without authority, basis or justification.

Under Congress' definition of loan originator, all entities are excluded. Loan originators are individuals employed by lender and mortgage broker entities for the purposes of taking residential mortgage loan applications and negotiating the terms of the transaction.[22] Under the Proposed Rule, the term "loan originator" is defined, without explanation, as encompassing these individuals as well as the entities that employ them. NAMB strongly believes that the definition of "loan originator" should not include these entities, and NAMB is confident that the issues the Board is seeking to remedy through the Proposed Rule will be resolved even if the Board limits its definition of "loan originator" to individuals, as Congress did under the SAFE Act.

[21] 74 Fed. Reg. at 43279.
[22] 12 U.S.C. §5102(3)(A)(i).

Defining lender and mortgage broker businesses as "loan originators" evidences a misunderstanding or under-appreciation for the value that these entities bring to the marketplace and the value of the work that goes into building, marketing and managing these entities and their employees. Such a definition also indicates a failure to recognize the complexities involved in a modern mortgage transaction, where a single entity may go back-and-forth throughout the application process between choosing to "broker" the loan or fund the transaction out of its own resources. In such a scenario, the Proposed Rule fails to reconcile how the compensation earned by such an entity should be treated, and how the changing roles of the entity might affect the content and timing of disclosures required under RESPA and TILA.

Additionally, the Board has not offered any analysis, evidence or studies demonstrating how it arrived at the conclusion that mortgage broker companies should be treated in the same manner under the Proposed Rule as the individual loan originators working for said companies. Expanding the definition of "loan originator" to include lender and mortgage broker businesses, and those engaged in "table funded" transactions, constitutes deliberate disparate treatment of small businesses that cannot, or choose not to, provide funds for mortgage transactions out of their own resources. By defining loan originator in this manner and seeking to prohibit certain payments to loan originators, the Board is regulating the compensation and profit structures for some business entities and not for others, which are in direct competition with those entities.

Even if it is not the Board's intent to treat similarly situated competitors differently, regulating the manner of compensation for some, but not all competing entities within the marketplace will have a disparate impact on those entities affected by the regulation.

Small businesses offering mortgage loan origination services will be negatively and disproportionately impacted by the Proposed Rule. Including lender and mortgage broker businesses in the definition of "loan originator" limits the flexibility and loan pricing and product options that these business entities can offer consumers in the marketplace. With no similar restrictions placed on typically larger direct competitors that choose to at least temporarily provide funds for mortgage transactions out of their own resources, competition will be limited and the smaller entities that have had their compensation regulated by the Proposed Rule will eventually be forced out of business.

NAMB strongly urges the Board to reconsider its proposed definition of "loan originator."

Just as NAMB believes it is important for there to be uniform regulation of competing entities in the mortgage industry, NAMB also believes it is critical that such regulation employ universally defined terms. Congress evidenced a desire to define loan originators as individuals under the SAFE Act. NAMB believes the Board should define loan originators in the same way, and if the Board should choose to define them differently, NAMB believes the Board must provide adequate justification for doing so.

Finally, the Board's choice to regulate compensation mechanisms exclusively at the loan originator level seems to ignore the depth and complexity of the secondary mortgage market. The type of incentive compensation that the Board seeks to prohibit was originally created by securitizers who were packaging loans and assigning value to their individual components. Only after these components were assigned some value did they become independent revenue streams. For example, with regard to prepayment penalties, it was generally only after the prepayment penalties were separately valued, securitized and sold in traunches that any offer of incentive compensation was contemplated for originators to originate loans with the penalties attached.

The Board has not offered any evidence or analysis of market data indicating why lender companies that receive incentive payments and compensation from secondary market sources are treated differently than mortgage broker companies under the Proposed Rule. Before finalizing the Proposed Rule, NAMB strongly urges the Board to examine the incentive payment and compensation structures utilized by Wall Street securitizers in their relationships with lenders such as New Century and Ameriquest. NAMB believes such an examination will reveal a critical flaw in the Proposed Rule and help illustrate the very important points raised above.

5. Prohibition on Payments to Loan Originators and Steering

As discussed above in greater detail, the 1994 HOEPA amendments to TILA authorized the Board to proscribe certain practices with regard to mortgage loans that the Board finds to be unfair, deceptive, or designed to evade the provisions of TILA.[23]

In the Proposed Rule, the Board seeks to use this authority to prohibit a creditor or other party from paying compensation to a loan originator based on a credit transaction's terms or conditions.[24] The prohibition would not apply to payments made by consumers directly to a loan originator, but would prohibit a loan originator from receiving compensation from any other party, in addition to the consumer, in connection with any transaction.

Currently, individual loan originators may be compensated in a number of different ways, including directly out of any fees paid by the consumer in the form of origination charges; in the form of salary and/or commission from the originator's employer; out of the proceeds from a lender or investor payment of YSP or SRP; or some combination thereof.

Borrower-paid origination charges and lender or investor payments vary in type and amount depending on numerous factors, including consumer preferences, the size and complexity of the transaction, wholesaler requirements, and issues presented by either the borrower or the property securing the loan. YSP and SRP are determined by the amount a lender or investor will pay to purchase a loan from the originator.

The amount that a lender or an investor will pay to purchase a loan, regardless of how the loan is originated, depends on the interest rate of the loan and the "par rate," or wholesale rate, established by said lender or investor. The wholesale rate is the interest rate at which the lender or investor will purchase the loan for a price equal to the face value of the loan. For example, a lender will pay a broker, or another lender, $100,000 to purchase a $100,000 loan originated at the wholesale rate. Lenders or investors may pay a premium above face value for a loan originated with an above wholesale interest rate. When paid to a mortgage broker, that premium is typically referred to as YSP. When paid to a lender, or an employee of a lender, the premium is generally described as SRP or an "overage." The Proposed Rule uses the term YSP to cover all such payments, regardless of the origination channel.

The Board believes that YSP can create financial incentives for loan originators to steer consumers to riskier loans for which loan originators will receive greater compensation.[25] Despite the fact that mortgage brokers have disclosed YSP on the GFE and HUD-1 since 1992, the Board believes that consumers generally are not aware of loan originators' alleged "conflict of interest" and cannot reasonably protect themselves against it.[26]

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[23] 15 U.S.C. §1639.
[24] 74 Fed. Reg. at 43279.
[25] 74 Fed. Reg. at 43240.
[26] Id.

However, the Board does acknowledge that YSP "may provide some benefit to consumers because consumers do not have to pay loan originators' compensation in cash or through financing."[27] Nevertheless, the Board believes that this benefit may be outweighed by costs incurred by consumers who obtain a higher interest rate or a loan with terms the consumer may not have otherwise chosen, such as a prepayment penalty or an adjustable rate.

To address these and other concerns related to loan originator compensation, the Proposed Rule seeks to eliminate all payments to loan originators that are based on the terms or conditions of a loan. Under the Proposed Rule, the term "loan originator" would include both mortgage brokers and employees of creditors who perform loan origination functions.[28]

The Board is specifically soliciting comment on whether the Proposed Rule would be effective in achieving its stated purpose, and also whether the Proposed Rule is feasible, practical, enforceable, or might lead to any unintended adverse consequences. The Board is also soliciting comment on whether loan originators should be prohibited from steering consumers to loans solely for the purpose of increasing the loan originator's compensation. Finally, the Board is soliciting comment on an alternative to the outright prohibition of all payments by creditors or other parties to loan originators. Under the alternative proposal, the Board would allow loan originators to receive payments that are based on the principal amount of the loan.

The Board's proposal to prohibit certain payments to loan originators rests entirely upon the Board's conclusion that such payments meet the standards for unfairness established in state unfair and deceptive trade practice statutes, by FTC, and in the courts. The Board does not discuss whether such payments meet the FTC's standards for deception.

NAMB questions whether the Board possesses the legal authority to regulate private compensation arrangements between employers and employees under TILA. However, even if the Board does possess such authority, NAMB believes the Board has failed to properly exercise the authority granted to it by Section 129(l)(2) of HOEPA. Specifically, NAMB believes the Board has not adequately demonstrated that the Proposed Rule satisfies the standards adopted by the FTC and the courts, and codified in 15 U.S.C. §45(n), for determining whether a practice is unfair or deceptive.

Because the HOEPA amendments to TILA do not set forth a standard for what is unfair or deceptive, the Board is instructed to look to the standards employed for interpreting state unfair and deceptive trade practices statutes and Section 5 of the FTC Act.[29]

Under the FTC Act, an act or practice is unfair when it causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the FTC is permitted to consider established public policies, but public policy considerations may not serve as the primary basis for an unfairness determination.[30] The FTC has interpreted these standards to mean that consumer injury is the central focus of any inquiry regarding unfairness.

The Board states in the Proposed Rule, "[f]or purposes of the FTC Act, an act or practice is considered unfair when it causes or is likely to cause substantial injury to consumers that is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to

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[27] Id.
[28] 74 Fed. Reg. at 43241.
[29] Conf. Rep. at 162.
[30] 15 U.S.C. §45.

competition."[31] The Board goes on to state, "the practice of basing a loan originator's compensation on the credit transaction's terms or conditions appears to meet these standards and constitute an unfair practice."[32]

Any analysis of unfairness under the FTC Act must begin with a determination of whether there has been substantial consumer injury. Consumer injury alone can be sufficient to warrant a finding of unfairness. However, this does not mean that every incident of consumer injury is unfair. Substantial injury is an objective test. To qualify as substantial, an injury must be real, and it must be large compared to any offsetting benefits.[33]

Specifically, a finding of unfairness must satisfy the following three-prong test: (1) the injury must be substantial; (2) the injury must not be outweighed by any countervailing benefits to consumers or competition;[34] and (3) the injury must be one that consumers themselves could not have reasonably avoided.[35]

a. <u>Injury Must Be Substantial</u>

Normally the marketplace is expected to be self-correcting, and we rely on the ability of individual consumers to make their own private purchasing decisions without regulatory intervention to govern the market. Consumers are expected to survey available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory.

Most of the FTC's unfairness matters are brought not to second-guess the wisdom of particular consumer decisions, but rather to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision making. The inquiry should begin by asking "whether the acts or practices at issue inhibit the functioning of the competitive market and whether consumers are harmed thereby."[36]

The Board maintains that when loan originators receive compensation based on a transaction's terms and conditions, they have an incentive to provide consumers loans with higher interest rates or other less favorable terms. Thus, the Board concludes, "yield spread premiums, therefore, present a significant risk of economic injury to consumers."[37]

The Board goes on to state that consumer injury is common because consumers typically are not aware of YSP or do not understand its implications. Further, the Board maintains that "while consumers expect the creditor to compensate its loan officers, they do not necessarily understand that these same loan originators may have the ability to increase the creditor's interest rate or include certain loan terms for the

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[31] Id.
[32] Id.
[33] J. Howard Beales, III, *The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection*, Journal of Public Policy & Marketing, Vol. 22, No. 2 (Fall 2003), pp. 192-200.
[34] Commission Statement of Policy on the Scope of Consumer Unfairness Jurisdiction (December 17, 1980), Reprinted in International Harvester Co., 104 F.T.C. 949, 1070, 1073 (1984) (Unfairness Policy Statement) (The FTC takes account of the various costs that a remedy would entail, including the costs to the parties directly before the agency and the burdens on society in general in the form of increased paperwork, increased regulatory burdens on the flow of information, and reduced incentives for innovation and capital formation.).
[35] Unfairness Policy Statement at 1073.
[36] Id., citing the FTC's Statement of Basis and Purpose, Advertising of 0phthalmic Goods and Services, 43 Fed. Reg. 23992, 24001 (1978).
[37] 74 Fed. Reg. at 43281.

originator's own gain."[38] And, "[b]ecause consumers generally do not understand the yield spread premium mechanism, they are unable to engage in effective negotiation. Instead they are more likely to rely on the loan originator's advice and frequently obtain a higher rate or other unfavorable terms solely because of greater originator compensation."[39] This leads the Board to again conclude that "[t]hese consumers suffer substantial injury by incurring greater costs for mortgage credit than they would otherwise be required to pay.[40]

YSP is not simply a means of compensating mortgage originators. YSP also serves consumer interests by affording greater flexibility in structuring loans, and enhancing consumer choice. For example, YSP is how mortgage originators get paid for the loan origination services they perform when a consumer chooses to pay none or only some of the origination fees or closing costs up front. These premiums are a legitimate and legal way for borrowers to forego paying their closing costs upfront and, instead, finance those costs through the interest rate. YSP finances those fees and costs, which results in the consumer paying a slightly higher interest rate.

No-cost and no-fee loans are offered widely by both mortgage broker and retail lender channels, and are made possible because of the YSP compensation structure. Thus, YSP is beneficial for many consumers who are ready to own a home but have to overcome the hurdle of significant closing costs, or for customers that choose to realize the savings of keeping their cash and financing their costs through their loan rate. Choosing to finance closing and origination costs through the rate allows borrowers to purchase and start building wealth through their home without requiring significant outlays of cash in addition to the downpayment at the outset of the loan.

YSP is also used to fund expenses which facilitate a mortgage transaction, but which neither the borrower nor lender is willing to bear. For example, mortgage originators often use YSP or SRP to pay for mortgage guaranty insurance, which, in a given transaction, may not be borne by either the borrower or lender. In such instances, the originator's net compensation is reduced accordingly.

In the Proposed Rule, the Board fails to provide any tangible evidence of substantial consumer injury resulting from creditor payments to loan originators. Instead, the Board seemingly relies upon the results of its prior consumer testing of various disclosure forms to determine that the practice of compensating loan originators through YSP has caused significant injury to consumers. However, the object of the Board's consumer testing was not to determine whether consumers had suffered any harm as a result of creditors' payment of YSP. Rather, the Board's testing was designed to judge the most effective means of disclosing YSP to consumers.

The Board also relies heavily on testimony, presented by interested parties at Board hearings conducted in 2006 and 2007, asserting that YSP provides incentives for loan originators to unnecessarily increase consumers' interest rates. However, the Board again failed to publish any evidence to support the claims made by these interested parties.

In fact, the Proposed Rule contains no reference to any verifiable evidence that supports the Board's assertion that creditor payments of YSP to loan originators have caused or are likely to cause substantial harm to consumers.

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[38] Id. at 43281-43282.
[39] Id.
[40] Id. at 43282.

To the contrary, the Board acknowledges that YSP can actually offer potential consumer benefits.[41] These benefits, unlike the harm asserted by the Board in the Proposed Rule, can be verified and are supported by independent university studies, which conclude "millions of households…have arranged mortgages through brokers, frequently more than once,"[42] and mortgage broker-originated loans are typically less-costly to borrowers than lender-originated mortgages after holding other loan terms and borrower characteristics constant.[43]

Moreover, loan originators' compensation is already sharply limited, by both legal restrictions, GSE limitations on originator compensation, and intense competition. Loan originators operate in a competitive marketplace and must compete on service, product, and price. To be competitive, loan originators cannot simply increase their interest rate on a loan product in the face of very substantial competition. The internet, newspapers, TV ads and the sheer number of loan originators in the marketplace make it difficult for any originator to charge higher fees or rates than the market supports and still remain in business for any period of time. Additionally, underwriting criteria limits yield spreads, and thus the premiums paid for those spreads. Borrowers, particularly non-prime borrowers, may have trouble meeting increasingly rigorous underwriting standards. Therefore, there may be little room to adjust the rate on a loan without negatively impacting loan-to-value and debt-to-income ratios, among other underwriting factors, and causing the borrower to be disqualified for the loan sought.

In order to satisfy the three-prong test for unfairness, the act or practice in question must cause a real, substantial injury to consumers.[44] Additionally, to satisfy the requirements of the APA, the Board must articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.[45] NAMB believes the Board has failed on both accounts with regard to its proposal for regulating originator compensation under TILA.

b. Injury Must Not Be Outweighed by Any Countervailing Benefits to Consumers or Competition

If it can be determined that there is substantial consumer injury, the next step in an unfairness analysis is to determine whether the harm is outweighed by any countervailing benefits to consumers or competition. High prices, for example, are not unfair in part because they provide important signals to other market participants to reallocate resources in ways that ultimately benefit consumers, such as entering the market or increasing production if they are already in the market.[46]

It is important to consider both the costs of imposing a remedy and any benefits that consumers enjoy as a result of the practice. For example, prohibiting creditors from compensating loan originators through YSP will significantly curtail originators' ability to work with consumers to tailor mortgage financing to the consumer's particular needs or circumstances. Although the Board maintains that the Proposed Rule would still afford creditors flexibility to structure loan pricing to preserve potential consumer benefits, such "flexibility" would be illusory. Each individual consumer is unique, and unlike loan originators, creditors do not interact with consumers on an individual basis. Therefore, even if the Proposed Rule would in fact preserve some flexibility for creditors, there would undoubtedly be increased transaction

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41 74 Fed. Reg. at 43282.
42 Broker Regulations Analysis at 2-3.
43 Mortgage Pricing Study at 1, 12.
44 J. Howard Beales, III, *The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection*, Journal of Public Policy & Marketing, Vol. 22, No. 2 (Fall 2003), pp. 192-200.
45 Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).
46 J. Howard Beales, III, *The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection*, Journal of Public Policy & Marketing, Vol. 22, No. 2 (Fall 2003), pp. 192-200.

costs for consumers because of loan originators' inability to quickly and seamlessly respond to consumers' often changing needs and circumstances throughout the course of a transaction.

Additionally, as noted above, YSP provides a tangible, verifiable benefit to consumers, both in terms of cost savings through the mortgage broker distribution channel, as well as flexibility and choice for borrowers seeking to reduce their up-front out-of-pocket costs when obtaining a mortgage. The Proposed Rule fails to undertake any meaningful cost-benefit analysis as required under the second prong of the unfairness test. The Board engages no discussion of the effect that a prohibition against YSP would have on competition, and despite identifying some of the potential benefits presented by YSP, the Board summarily dismisses those benefits and fails to discuss others. In the end, the Board resolves its cost-benefit analysis by simply asserting that consumers are largely incapable of understanding YSP and are therefore unable to adequately protect themselves from the perceived risk associated with it.

The Board never quantifies and really never discusses the injury to consumers that the Proposed Rule purports to remedy. Rather, the Board continues to press forward with the proposed prohibition against YSP based solely upon the notion that consumers will never adequately understand YSP.

c. <u>Injury Must Be One that Consumers Could Not Have Reasonably Avoided</u>

Finally, a practice is only unfair if the injury is not one that a consumer could reasonably avoid. This third prong of the unfairness test underscores the importance of promoting consumer choices and not second-guessing those choices.

The concept of reasonable avoidance is designed to prevent agencies, like the Board, from substituting its own paternalistic judgment and choices for those of informed consumers. Nevertheless, this is precisely what the Board seeks to accomplish with the Proposed Rule.

The Board maintains that YSP creates a conflict of interest between the loan originator and the consumer that cannot be remedied by disclosures. Additionally, the Board asserts that most consumers are not aware of the existence of YSP and do not have an understanding of how it can work to their benefit. Here too, the Board maintains that this lack of consumer understanding cannot be remedied by disclosures. Instead, the Board concludes that because consumers are not sufficiently informed, and apparently cannot be sufficiently informed about YSP, they therefore cannot be expected to make reasonable choices and avoid the risk of financial harm that the Board believes is associated with YSP.

A significant obstacle standing in the way of greater consumer understanding of YSP is the unequal disclosure of YSP across different distribution channels. In putting forth the Proposed Rule, the Board relies heavily upon the results of its consumer testing of mortgage disclosures to conclude that a prohibition against YSP is necessary to protect consumers. However, the Board's consumer testing of those disclosures was fatally flawed, as evidenced by the Board's withdrawal of the 2008 proposed TILA revisions relating to mortgage broker compensation.

Nevertheless, rather then revisit the issue of improving consumer disclosures relating to YSP, the Board has put forth the Proposed Rule prohibiting YSP altogether. While imposing such a prohibition may arguably fall within the Board's jurisdiction over unfair or deceptive acts or practices relating to mortgage transactions under Section 129(l)(2) of TILA, NAMB believes the Board is exceeding its authority in issuing the Proposed Rule.

Congress enacted TILA for the purpose of assuring the meaningful disclosure of credit terms so that consumers would be able to compare more readily the various credit terms available and avoid the uninformed use of credit.[47] The Board is charged with implementing TILA.

At its core, TILA is a disclosure statute. Yet, in the Proposed Rule, the Board abandons its earlier efforts to improve the disclosure of YSP for consumers, instead opting to prohibit YSP altogether. As noted above, the point of the reasonable avoidance test is to prevent second-guessing of consumer choices. The Board should not be in the business of trying to second guess market outcomes when the benefits and costs of the regulated act or practice are very closely balanced or when the existence of the purported consumer injury is itself disputed.[48] Unwise consumer choices are a strong argument for enhanced consumer education and disclosure, not sweeping regulation.[49]

Further, because TILA is first and foremost a disclosure statute, it is improper for the Board to make a determination that the payment of YSP to loan originators is *per se* unfair or deceptive. Such a determination should be made, if it is to be made, by Congress, not the Board.[50]

d. <u>"Alternative 2" -- Permits Compensation Based on the Loan Amount</u>

In addition to the proposal prohibiting any payment to a loan originator based upon the terms or conditions of a loan, the Board is publishing for comment an alternative proposal designated as "Alternative 2 - Paragraph (d)." This proposal would allow loan originator compensation to be based on the loan amount, which would not be considered a transaction term or condition for purposes of the proposed prohibition. Under Alternative 2, a loan originator could be paid a fixed percentage of the loan amount, even though the dollar amount paid by a particular creditor would vary from transaction to transaction and would increase as the loan amount increases. This alternative would also permit compensation paid as a percentage of the loan amount to be subject to specified minimum and maximum dollar amounts.

Today, many mortgage originators earn some or a major portion of their compensation as a percentage of the loan amount. Additionally, as the Board correctly states in the Proposed Rule, numerous other participants in the mortgage market, including creditors, mortgage insurers and other service providers earn their compensation based upon a percentage of the loan amount as well.

NAMB reiterates its objections to the original proposal with regard to Alternative 2. Specifically, this alternative, like the primary alternative, fails to meet the threshold requirements for declaring a practice unfair or deceptive under the FTC guidelines.

However, NAMB does believe that Alternative 2 could, with some improvements, be properly revised and re-proposed for comment without the risk of harm to consumers and competition that it currently poses.

[47] 15 U.S.C. §1601.
[48] J. Howard Beales, III, The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection, Journal of Public Policy & Marketing, Vol. 22, No. 2 (Fall 2003), pp. 192-200.
[49] Id.
[50] Id.

e. Prohibition on Compensation from Both the Consumer and Another Source

The Proposed Rule would also provide that if a loan originator is compensated directly by a consumer, no other person may pay any compensation to the originator in conjunction with that transaction. The Board believes this prohibition will improve transparency for consumers by requiring all originator compensation to come from either the borrower or the creditor, but never both.

The Board's stated concern regarding loan originator compensation coming from multiple sources is that consumers are unlikely to understand through disclosure that the fee they are charged by the originator does not necessarily represent the total compensation the originator will earn on the transaction. Therefore, consumers are unlikely to use the dual compensation structure to their advantage and attempt to negotiate more favorable terms or pricing.

NAMB strongly opposes the Board's proposal to eliminate the option for dual compensation for loan originators. Currently, consumers have an array of options when it comes to compensating their loan originator for his or her services and/or financing some or all of their closing costs. Under this proposal, consumers could be unreasonably and unnecessarily restricted to an all or nothing choice with regard to their up-front out-of-pocket costs.

NAMB also opposes the Board's interpretation that YSP paid by a creditor to a loan originator, and characterized on the RESPA disclosures as a "credit" to the borrower, should not be considered a payment received directly from the consumer for purposes of the dual compensation prohibition under the Proposed Rule. Under the new RESPA rule, effective January 1, 2010, loan originators in mortgage broker transactions are required to disclose their total origination charge upfront on the GFE. Consumers are then free to choose how they would like to pay for that origination charge, as well as any other settlement services charges they are responsible for. Consumers may choose to pay the full amount in cash, or they may elect to offset their out-of-pocket obligation at closing by choosing a higher interest rate on the transaction. In the case of the latter, the creditor effectively fronts or "credits" the necessary cash to the borrower for payment of the loan originator's fee and the fees for any other settlement services that the borrower cannot or chooses not to pay for out of his or her own resources. In any event, the loan originator is compensated in the same amount and functionally in the same manner regardless of whether the borrower elects to pay in cash or utilize the offer of "credit" extended by the creditor.

Moreover, because the new RESPA disclosure requirements for creditor payments to loan originators only apply in mortgage broker transactions, the Board's interpretation of a payment disclosed as a "credit" to the borrower under RESPA further illustrates the disparate treatment of mortgage brokers that permeates throughout the Proposed Rule. This interpretation also harms consumers because it severely limits consumer choice, and could even prevent some borrowers from being able to obtain a mortgage altogether. For example, if a consumer has sufficient funds to cover some, but not all of his closing costs, under the Proposed Rule he will have no choice but to roll those costs into a higher loan amount or interest rate, which could affect his ability to qualify for the loan.

For these reasons, NAMB encourages the Board to revise the Proposed Rule and properly characterize creditor payments to loan originators, which are disclosed as a "credit" to the borrower on the GFE, as payments made directly by the consumer.

f. NAMB Proposes a Substitute "Alternative 3"

While NAMB supports some aspects of the Board's proposed "Alternative 2," NAMB strongly recommends that the Board consider an entirely new "Alternative 3."

This proposed alternative would define loan originators in the same manner as in the SAFE Act, and would regulate all direct and indirect payments to loan originators in the manner proposed by the Board in Alternative 2 (including all comments). All payments received by a mortgage broker business, other than any payment made directly by the borrower, would be deemed a secondary market payment to the business, just as similar payments made to lender businesses are deemed secondary market payments today.

NAMB believes that the non-exclusive list of payments in the Proposed Rule – *i.e.*, payments based on credit score, loan volume, geographic differences, loan performance, documentation quality and quality control – should be considered secondary market payments to the mortgage broker company, since such payments reflect the sound management and business risk associated with the net-proceeds of business operations rather than commissions received by an individual loan originator dealing directly with consumers. By using this approach, the Board would better reflect and match business operations that are competing in the marketplace, rather than employing the random approach proposed in "Alternative 2," which treats mortgage broker companies in the same manner as their employees and the employee originators working at competing lender companies.

NAMB strongly urges the Board to explore this proposed Alternative 3 and determine the benefits of such an alternative prior to finalizing any rule.

g. Prohibition on Steering

Finally, the Board is soliciting comment on whether it should adopt a rule prohibiting loan originators from "steering" consumers into particular loans solely to increase the originator's compensation.

NAMB appreciates the importance of ensuring that loan originators are not incentivized to steer consumers toward particular loan products based solely upon the compensation or profit they or their employer are likely to receive from the transaction. However, NAMB strongly believes that an anti-steering rule will only be effective if its reach does not limit or remove financing options from borrowers.

NAMB believes the Board should adopt a rule prohibiting loan originators from steering consumers into particular loans, but only if such a rule expressly states:

> For any mortgage loan, the total amount of direct and indirect compensation from all sources permitted to a mortgage originator may not vary based on the terms of the loan (other than the amount of the principal). For any mortgage loan, a mortgage originator may not arrange for a consumer to finance through rate any origination fee or cost except bona fide third party settlement charges not retained by the creditor or mortgage originator. However, a mortgage originator may arrange for a consumer to finance, through rate, an origination fee or cost if the mortgage originator does not receive any other compensation from the consumer except the compensation that is financed through rate.

Although NAMB strongly opposes the Board's proposal to prohibit loan originator compensation from dual sources, NAMB believes it is important to ensure that loan originators are not provided incentives to steer consumers into loan products for their own financial gain. For this reason, NAMB would support an anti-steering rule that permits a single stream of loan originator compensation, provided that the term loan originator is defined properly, as it is under the SAFE Act, and all entities competing in the market for origination services would be permitted to receive both primary and secondary market compensation, as described in detail in NAMB's proposed "Alternative 3" above.

Additionally, NAMB's support for any anti-steering rule is contingent upon the inclusion of specific prohibitions against: (1) loan originators steering any consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay; (2) refinancing a residential mortgage loan without a net tangible benefit to the consumer; (3) loan originators steering any consumer to a residential mortgage loan that has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms); (4) abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age; and (5) loan originators assessing excessive points and fees (as such term is described under section 103(aa)(4) of the Truth in Lending Act (15 U.S.C. 1602(aa)(4))) to a consumer for the origination of a residential mortgage loan based on such consumer's decision to finance all or part of the payment through the rate for such points and fees.

NAMB does not support any anti-steering rule that would affect yield spread premiums or other similar indirect compensation; affect the mechanism for providing the total amount of direct and indirect compensation permitted to a loan originator; limit or affect the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser; or restrict a consumer's ability to finance, through principal or rate, any origination fees or costs permitted or the mortgage originator's ability to receive such fees or costs (including compensation) from any person, so long as such fees or costs were fully and clearly disclosed to the consumer earlier in the application process and do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision about whether to finance such fees or costs.

Earlier this month, the U.S. House of Representatives passed legislation that included the above anti-steering language. This anti-steering language was part of the "Mortgage Reform and Anti-Predatory Lending Act," which was passed as one component of H.R. 4173, the "Wall Street Reform and Consumer Protection Act of 2009." NAMB strongly believes that any anti-steering prohibition contemplated by the Board should mirror this anti-steering legislation passed by Congress. Should the Board elect to move forward with a prohibition on steering that differs in form or substance from what is included in H.R. 4173, NAMB believes the Board must provide adequate justification for doing so.

VI. Policy Recommendations / Alternatives to the Proposed Rule

For the reasons detailed herein, NAMB respectfully urges the Board, when contemplating how best to achieve the policy aims of the Proposed Rule, to consider the following policy recommendations, proposed revisions, and possible alternatives.

A. Withdraw the proposed prohibition on payments to loan originators.

NAMB strongly urges the Board to withdraw the proposed prohibition on payments to loan originators that are based on the terms or conditions of a loan.

As discussed at length above, the proposed prohibition on payments to loan originators fails to satisfy the requirements of the three-prong test for determining unfairness established by the FTC, and will likely lead to increased costs and fewer choices for mortgage consumers. Specifically, the Proposed Rule fails to adequately demonstrate that such payments to loan originators cause substantial harm to consumers, are not outweighed by countervailing benefits to consumers or competition, and are not reasonably avoidable by consumers.

Additionally, the Proposed Rule fails to discuss the standards employed by any state in the interpretation of its unfair or deceptive trade practices statute.

B. Delay implementation of any final rule until after Congress has acted upon currently proposed legislation that would create a new Consumer Financial Protection Agency.

Earlier this month, the U.S. House of Representatives passed H.R. 4173, the "Wall Street Reform and Consumer Protection Act of 2009," which would revamp the nation's financial regulatory system and potentially vest a new agency with authority over mortgage disclosures and other consumer protection issues. The U.S. Senate is expected to take up companion legislation early next year. With such legislative proposals under consideration in both chambers of Congress, NAMB recommends delaying implementation of any final rule until after Congress has acted upon this legislation.

It is costly and burdensome for industry participants to implement any new disclosure regime, and the industry is already bearing significant costs in terms of education, training and production of the new GFE form, required under HUD's 2008 RESPA revisions and effective January 1, 2010.

Additionally, it can be unnecessarily confusing to consumers who have previously entered into mortgage transactions, and are therefore familiar with current required disclosures, to be subjected to a perpetual cycle of new disclosures.

C. Permit either the creditor, or a mortgage broker or other third-party originator to provide the required pre-application disclosures.

The Proposed Rule requires creditors to make pre-application disclosures. Because the Proposed Rule requires creditors to make these pre-application disclosures and fails to account for the fact that mortgage brokers and other third-party originators are often the ones making first contact with consumers and taking applications, the Proposed Rule poses a compliance problem for creditors, as well as these other entities. NAMB recommends revising the language of the Proposed Rule to permit either the creditor, or a mortgage broker or other third-party originator, to provide the required pre-application disclosures.

D. Eliminate disclosure of the APR and instead require disclosure of payment terms, settlement costs and monthly payment.

NAMB supports efforts to provide clearer and more conspicuous consumer disclosures. This is why NAMB believes the Board should discontinue disclosure of the APR, particularly on early, consumer shopping disclosures.

According to the Proposed Rule, Board testing showed that consumers do not typically understand the APR and do not use the APR effectively as a shopping tool. NAMB strongly encourages the Board to make real improvements to the early TILA disclosures received by consumers by highlighting information that really matters to consumers, including monthly payment, payment terms and settlement costs.

E. Establish a reasonable tolerance threshold, within which certain terms could change after the final TILA disclosure but prior closing without requiring re-disclosure and without triggering an additional waiting period.

NAMB supports the Board's second alternative approach outlined in the Proposed Rule, where a tolerance threshold would be established within which certain terms could change and be re-disclosed without triggering an additional waiting period. Including some tolerance in the proposed final TILA disclosure requirements would be beneficial for lenders, allowing for some flexibility, and will reduce the likelihood of potential litigation between real estate buyers and sellers where a series of mandatory re-disclosures preventing the sale from closing could result in breach of contract by the buyer.

F. Define "loan originators" in the same way that they are defined under the SAFE Act.

The SAFE Act defines a "loan originator" as an individual who takes a residential mortgage loan application, and offers or negotiates terms of a residential mortgage loan for compensation or gain.[51] The SAFE Act also effectively increases oversight over loan originators by mandating their registration with the Nationwide Mortgage Licensing System and Registry ("NMLSR"). Through the NMLSR, every loan originator is assigned a unique identifier, through which bad actors may be identified and tracked, both for personal conduct and loan-specific activities.

NAMB strongly believes the Board should implement the same definition of "loan originator" that is used in the SAFE Act. Consistency and uniformity of regulation are paramount to achieving real consumer protection, and NAMB is confident that the issues the Board is seeking to remedy through the Proposed Rule will be resolved even if the Board limits its definition of "loan originator" to individuals, as Congress did under the SAFE Act.

G. Ensure that loan originators retain their ability to receive compensation as a percentage of the loan amount and not just a flat fee.

Today, many loan originators earn some or all of their compensation as a percentage of the loan amount. Additionally, as the Board correctly states in the Proposed Rule, numerous other participants in the mortgage market, including creditors, mortgage insurers and other service providers earn their compensation based upon a percentage of the loan amount as well.

In an effort to ensure that loan originators retain their ability to receive compensation as a percentage of the loan amount and not just a flat fee, NAMB encourages the Board to adopt a modified version of Alternative 2 to the proposal prohibiting any payment to a loan originator based upon the terms or conditions of a loan.

NAMB believes that Alternative 2, including all comments, represents an appropriate means of regulating payments to loan originators, provided that the term loan originator is defined as having the same meaning as under the SAFE Act.

H. Explore the benefits of an "Alternative 3" to the proposal prohibiting payments to loan originators based upon the terms or conditions of a loan, and publish for comment a new proposed rule that includes such an alternative.

NAMB proposes a new "Alternative 3" to the proposed prohibition against payments to loan originators based upon the terms or conditions of a loan. Under NAMB's proposed Alternative 3, loan originators would be defined in the same manner as in the SAFE Act, and all direct and indirect payments to loan originators would be regulated as proposed by the Board in Alternative 2 (including all comments). However, all payments received by a mortgage broker company, other than any payment made directly by the borrower, would be deemed a secondary market payment to the mortgage broker company, just as similar payments made to lender companies are deemed secondary market payments today.

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[51] 12 U.S.C. §5102(3)(A)(i).

NAMB believes that the non-exclusive list of payments in the Proposed Rule – i.e., payments based on credit score, loan volume, geographic differences, loan performance, documentation quality and quality control – should be considered secondary market payments to the mortgage broker company, since such payments reflect the sound management and business risk associated with the net-proceeds of business operations rather than commissions received by an individual loan originator dealing directly with consumers. By using this approach, the Board would better reflect and match business operations that are competing in the marketplace, rather than employing the random approach proposed in "Alternative 2," which treats mortgage broker companies in the same manner as their employees and the employee originators working at competing lender companies.

NAMB strongly urges the Board to explore this proposed Alternative 3, and republish for comment a proposal implementing the concepts outlined above.

I. Adopt an anti-steering rule that mirrors the anti-steering rule in H.R. 4173.

NAMB believes the Board should adopt a rule prohibiting loan originators from steering consumers into particular loans, but only if such a rule expressly states:

> For any mortgage loan, the total amount of direct and indirect compensation from all sources permitted to a mortgage originator may not vary based on the terms of the loan (other than the amount of the principal). For any mortgage loan, a mortgage originator may not arrange for a consumer to finance through rate any origination fee or cost except bona fide third party settlement charges not retained by the creditor or mortgage originator. However, a mortgage originator may arrange for a consumer to finance, through rate, an origination fee or cost if the mortgage originator does not receive any other compensation from the consumer except the compensation that is financed through rate.

Additionally, the rule must apply exclusively to individual loan originators, as defined in the SAFE Act, and prohibit such originators from steering a consumer to a residential mortgage loan that the consumer lacks a reasonable ability to repay. In the case of a refinancing of a residential mortgage loan, the mortgage originator must provide the consumer with a net tangible benefit. The rule must also prohibit mortgage originators from steering any consumer to a residential mortgage loan that has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms); prohibit abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age; and prohibit mortgage originators from assessing excessive points and fees (as such term is described under section 103(aa)(4) of the Truth in Lending Act (15 U.S.C. 1602(aa)(4))) to a consumer for the origination of a residential mortgage loan based on such consumer's decision to finance all or part of the payment through the rate for such points and fees.

Finally, the rule should not affect yield spread premiums or other similar incentive compensation; should not affect the mechanism for providing the total amount of direct and indirect compensation permitted to a loan originator; should not limit or affect the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser; and should not restrict a consumer's ability to finance, through principal or rate, any origination fees or costs permitted or the mortgage originator's ability to receive such fees or costs (including compensation) from any person, so long as such fees or costs were fully and clearly disclosed to the consumer earlier in the application process and do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision about whether to finance such fees or costs.

J. Address all "up selling" in connection with mortgages and other financial transactions, not just YSP.

Although the role of public policy is necessarily and properly limited in judging the unfairness of an act or practice under FTC guidelines, it may be proper to examine other established public policies in an effort to determine whether a particular practice is unfair. As the Commission noted in its 1980 Policy Statement, reference to other public policies may provide additional evidence of consumer injury or, conversely, it may influence the Commission to reconsider its tentative view that a practice is injurious in its net effects, and, therefore, unfair. A thorough analysis of such policies "can serve as an important check on the overall reasonableness of the Commission's action."[52]

NAMB believes that such an examination of other established public policies may be proper here, and that such an exploration would reveal that the Board's view regarding the payment of YSP to loan originators is erroneous.

According to the Board, YSP essentially amounts to up selling in its most basic form. Up selling is a sales technique employed in virtually every industry, whereby a salesperson offers a customer an opportunity to purchase more expensive items, upgrades, or other add-ons in an attempt to make a more profitable sale. The Proposed Rule defines YSP as the present dollar value of the difference between the lowest interest rate a wholesale lender would accept for a given transaction and the interest rate the loan originator actually obtains for that wholesaler.

Up selling usually involves marketing more profitable services or products, but up selling can also be simply exposing the customer to other options he or she may not have considered previously. Up selling is not only permitted, but quite common throughout the mortgage industry and in virtually every other industry where financial transactions occur.

NAMB encourages the Board to withdraw its proposed prohibition against up selling by loan originators. Alternatively, NAMB encourages the Board to explore restricting, but not completely prohibiting up selling in the form of YSP. For example, the Board should look into the possibility of permitting limited up selling in mortgage transactions within a narrow band, such as 2 percent. This could help preserve financing options for consumers and allow some room for borrowers to negotiate more favorable terms or conditions.

If Board maintains its belief that YSP is unfair, *per se*, and persists in its attempts to prohibit YSP from being paid in any mortgage transaction, then NAMB believes the Board must also address the other instances of up selling that occur in connection with mortgage transactions and the premium payments that are made to individuals and entities other than the loan originator.

Similarly, the Board should explore instances of up selling that occur in connection with financial transactions outside of the mortgage industry, such as those occurring in the credit card, insurance and automobile industries.

VII. Compliance with the Administrative Procedures Act

The rulemaking process by federal agencies, including the Board, is governed by the Administrative Procedures Act ("APA"), which sets forth clear standards that any proposed rulemaking must meet. In its

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[52] Letter from the FTC to Hon. Bob Packwood and Hon. Bob Kasten, Committee on Commerce, Science and Transportation, United States Senate, Reprinted in FTC Antitrust & Trade Reg. Rep. (BNA) 1055, at 568-570 (Packwood-Kasten Letter).

current form, the Proposed Rule fails to comply with some of the most critical APA standards. Moreover, because of the materiality of those shortcomings, they may not be remedied in the final rule. At a minimum, the APA concerns relating to the Proposed Rule require the rule to be proposed again in a form which satisfactorily addresses those concerns, and which permits the public to comment upon changes and additions to the Proposed Rule's rationales and supporting materials.

The animating principles of the APA are relatively straight-forward: an agency may not abuse its authority by acting either arbitrarily or unilaterally. Although agencies develop regulations pursuant to statutory authority, they nonetheless may only act after articulating an adequate rationale for the proposed action, and identifying any data, studies, or analyses supporting the proposed policy course. Moreover, that rationale and supporting authorities must be presented to the public, which in turn must be given an opportunity to comment on the proposed rule and its premises. In short, an agency may not simply assert that a regulation is in the public interest, it must demonstrate that the regulation is so, and it must afford the public it presumes to serve the right to examine and challenge the rule's premises.

Under the APA, if the final rule is not adequately justified by the rationale articulated by the issuing agency, if that rationale is not properly supported by the facts and data presented, or if the facts and data are not timely presented to the public to permit comment prior to adoption of a final rule, that rule is not valid. As the U.S. Circuit Court for the District of Columbia made clear in Association of Data Processing Service Organizations, Inc. v. Board of Governors of the Federal Reserve System, Section 706(2)(A) of the APA "enable[s] the courts to strike down, as arbitrary, agency action that is devoid of needed factual support."[53]

A. The Proposed Rule fails to articulate an adequate rationale and supporting basis for key provisions.

The APA requires agencies to "incorporate in the rules adopted a concise general statement of their basis and purpose."[54] As the U.S. Supreme Court has stated:

> [T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made. . . . In reviewing that explanation, [the Court] must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.[55]

The U.S. Circuit Court for the District of Columbia has further developed the standard which an agency must meet when proposing a rule, stating, "It is well established that 'an agency must cogently explain why it has exercised its discretion in a given manner,' and that explanation must be 'sufficient to enable us to conclude that the [agency's action] was the product of reasoned decision-making.'"[56]

Just last year, the U.S. District Court for the District of Columbia had occasion to apply these criteria in the housing context in AmeriDream v. Jackson.[57] In AmeriDream, the court considered a HUD

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[53] Ass'n of Data Processing Svc. Orgs., Inc. v. Bd. of Govs. of Fed. Reserve System, 745 F.2d 677, 683 (D.C. Cir. 1984).
[54] 5 U.S.C. §553(c).
[55] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983)(internal quotation marks and citations omitted).
[56] United States Telecom Ass'n v. FCC, 227 F.3d 450, 460 (D.C. Cir. 2000) (quoting A.L. Pharma, Inc. v. Shalala, 62 F.3d 1484, 1491 (D.C. Cir. 1995)).
[57] AmeriDream v. Jackson, Civil Action No. 07-1752 (PLF)(D.D.C. 2008).

regulation that would have eliminated charitable downpayment assistance programs which had provided homebuyers with funds to make the minimum downpayments required to qualify for Federal Housing Administration loans. In its notice of proposed rulemaking, and again in the final rule, HUD sought to justify the regulation by alleging misconduct and asserting that the rule was needed to protect consumers. However, the court vacated and remanded the HUD rule. The court held that HUD's rule failed muster under the APA on several grounds, including its failure to articulate an adequate rationale, and that HUD's insistence that it acted in the public interest did nothing to remedy those failings.

In AmeriDream, the court found grounds to invalidate the HUD regulation based on the fact that "[HUD] explicitly (and inexplicably) relies on sources that do not support its conclusions."[58] The court further observed that "HUD's explanation in this case strongly suggests that the agency did not genuinely engage in reasoned decision-making because neither of the sources upon which HUD permissibly relied supports the Final Rule's stated rationale."[59]

The Proposed Rule exhibits similar shortcomings. Most obvious, perhaps, is the Proposed Rule's reliance on a 2003 AARP Survey to justify imposing new requirements on loan originator compensation when that Survey refuted the very point it was presented as supporting. More generally, the Proposed Rule fails to cite any bases for some of its key provisions, and did not address other relevant information that was readily available.

Under the APA, issuing regulations and presenting policy proposals without first conducting the appropriate research is simply not enough. As the D.C. District Court noted in AmeriDream, "[There] is no substitute for the Secretary himself reviewing the record materials, examining the relevant data, and coherently articulating the decision he made and the bases on which he in fact rested his finding – which is, of course, his obligation under the APA."[60]

The Board's failure to conduct essential research prior to issuing the Proposed Rule does not constitute "reasoned decision-making" under the APA. The Board proposed key policies without first conducting the research to which it had committed, soliciting critical input from the public, or giving proper consideration to some of the most relevant and authoritative studies in the field. The Board must conduct further research into the operation of mortgage markets and the efficacy of the proposed disclosures and prohibitions, utilizing all these sources of information. The Board should then disclose its findings anew to the public in a subsequent proposal to permit proper consideration of the Proposed Rule.

B. The Proposed Rule failed to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them.

The APA requires an agency engaged in a rulemaking proceeding to consider less restrictive, reasonable alternatives for its chosen policies and offer a reasoned explanation for rejecting them. In City of Brookings Municipal Telephone Company v. FCC, the D.C. Circuit Court stated:

> It is well settled that an agency has 'a duty to consider responsible alternatives to its chosen policy and to give a reasoned explanation for its rejection of such alternatives.' Of course . . . this duty extends only to 'significant and viable' alternatives, not to 'every alternative device and thought conceivable by the mind

[58] Id. at 17.
[59] Id. at 18.
[60] Id. at 19, quoting Milk Indus. Found. v. Glickman, 949 F. Supp. 882, 895 (D.D.C. 1996).

> of man.' . . . But with that sensible caveat, the fact remains that '[t]he failure of an agency to consider obvious alternatives has led uniformly to reversal.'[61]

The Proposed Rule fails to address many such alternatives to achieve its stated policy goals. For example, with respect to the proposed restrictions on loan originator compensation, the Proposed Rule makes no attempt to assess the merits of several clear alternatives, including those already provided by current or proposed law and industry practice; those presented by the federal government's principal consumer protection agency, the FTC, and those presented by HUD in its proposed RESPA rules, with which the Proposed Rule stated it would be coordinated.

The Proposed Rule's failure to consider such alternatives must be remedied if it is to withstand scrutiny under the APA. As noted, the Proposed Rule must consider a full range of alternative means to achieve the articulated policy goals, many of which are identified in this comment letter, and subject each of those possible alternatives to rigorous examination to determine, based on all available studies and the most thorough empirical research, which alternative best achieves the policy objectives. In particular, the Board must carefully consider data and quantifiable evidence produced by other government agencies with particular expertise in the subject area and independent academic researchers whose backgrounds permit them to make an informed and disinterested assessment of the relevant facts.

C. The Proposed Rule solicits significant new data or other information relevant to its provisions, impermissibly denying the public the opportunity to comment.

On numerous points, the Proposed Rule solicits significant new data or other information relevant to its provisions. Although the Board should seek that information, that is only the first step in the rulemaking process. In addition, commenters on the Proposed Rule must also have the opportunity to review and comment on any studies or data upon which the Board relies in developing any proposed regulations. By soliciting information in the Proposed Rule, rather than gathering it earlier and presenting it in the Proposed Rule, the Board is impermissibly denying commenters essential input into the final rule. Unless the public is afforded that opportunity, the Proposed Rule cannot stand under the APA.

D. The Board must re-propose its revisions to Regulation Z to permit public comment on rationales and supporting data not presented not in the Proposed Rule.

As the D.C. Circuit court stated in Data Processing Service Organizations v. Federal Reserve, "[T]he most critical factual material that is used to support the agency's position on review . . . [must be] made public in the proceeding and exposed to refutation."[62] Inadequate rationales or insufficient bases must not only be corrected. Once corrected, they must again be subject to public comment and refutation. As the D.C. Circuit Court stated in Brookings Municipal Telephone Company v. FCC, "Post hoc rationalizations advanced to remedy inadequacies in the agency's record or its explanation are bootless."[63]

Given the extent and materiality of the Proposed Rule's (i) failure to articulate an adequate rationale and supporting basis for key provisions; (ii) failure to consider less restrictive, reasonable alternatives for its chosen policies; and (iii) solicitation of significant new data or other information relevant to its provisions, those shortcoming can only be remedied by presenting another proposed regulation which includes all material information which the Board may regard as a basis for a final rule.

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[61] City of Brookings Municipal Telephone Co. v. FCC, 822 F.2d 1153, 1165 (D.C. Cir. 1987)(citations omitted).
[62] 745 F.2d at 684.
[63] 822 F.2d at 1165.

E. The Board must address key questions before moving forward in the rulemaking process.

In re-proposing the Proposed Rule, the Board must not simply present its updated research or discuss alternatives; it must also address the policy concerns raised by the Proposed Rule's provisions. Particular attention must be given to those legitimate objections which have been raised by commenters.

Courts have insisted on that serious policy concerns presented by commenters must be addressed, specifically and thoroughly, by an agency to meet its obligations under the APA. As the D.C. Court of Appeals, the leading appellate court for APA matters, stated in Covad Communications Co. v. FCC, an agency "need not address every comment, but it must respond in a reasoned manner to those that raise significant problems."[64] In Canadian Association of Petroleum Producers v. FERC, that same court held, "Unless the Commission answers objections that on their face seem legitimate, its decision can hardly be classified as reasoned."[65]

As detailed in this comment letter, the Proposed Rule presents many important questions and prompts many legitimate objections. For example, how does the Board justify endeavoring to regulate loan originator compensation due to a perceived "risk" of financial harm, when its basis for doing so rests exclusively on assumptions and anecdotal evidence of past consumer and originator behavior and ignores independent research contradicting the reality of such harm? Similarly, how does the Proposed Rule purport to protect the interests of consumers and encourage comparative shopping when it effectively reduces the flexibility that originators have to work with consumers to tailor a loan product to their particular goals and circumstances?

Prior to finalizing any regulation, the Board must respond to those questions and many others raised in this comment letter. NAMB looks forward to that response, and is committed to continuing to work with the Board to develop policies that best serve the public interest.

VIII. Conclusion

NAMB applauds the Board's forceful response to the problems facing our mortgage markets, and NAMB shares the Board's resolute commitment to consumer protection and improved disclosure of critical information. However, NAMB strongly objects to the elements of the Proposed Rule that will not serve the best interests of consumers or the market.

Specifically, NAMB believes that the Board's goals to simplify and clarify disclosures for consumers and prohibit anti-steering are not successfully accomplished through the proposed changes to Regulation Z. In fact, NAMB is concerned that the changes, as proposed, fail to achieve those goals and actually contradict their overall purpose.

The proposed amendments to Regulation Z make the entire mortgage process more complex for borrowers, exacerbate and compound the already complicated practices that exist, and most importantly, eliminate consumer choice. Therefore, NAMB respectfully urges the Board to withdraw the proposed amendments; perform more qualified consumer testing (utilizing the results in an effective manner); engage and confer with seasoned, knowledgeable industry experts to obtain credible and useful insights and information; and reissue the proposal after addressing the substantive legal, procedural and policy concerns identified in this letter.

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[64] Covad Communications Co. v. FCC, 450 F.3d 528, 550 (D.C. Cir. 2006).
[65] Canadian Ass'n of Petroleum Producers v. FERC, 254 F.3d 289, 299 (D.C. Cir. 2001).

IX. Further Information

For further information, please contact:

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Respectfully submitted,

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2009-2010 NAMB President